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FISCAL YEAR 1984 HUD AUTHORIZATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

FUNDING AUTHORIZATIONS FOR HOUSING AND COMMUNITY DEVELOPMENT PROGRAMS FOR FISCAL YEAR 1984

MARCH 8, 9, AND 10, 1983

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FISCAL YEAR 1984 HUD AUTHORIZATIONS

TUESDAY, MARCH 8, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator John G. Tower presiding.

Present: Senators Tower, Garn, Heinz, Riegle, Sarbanes, Dodd, Sasser, and Lautenberg.

OPENING STATEMENT OF SENATOR TOWER

Senator TOWER. The subcommittee will come to order.

The Subcommittee on Housing and Urban Affairs begins its fiscal year 1984 HUD hearings with two major objectives in mind.

First, we intend to take every step necessary to support the housing recovery currently underway. It has been demonstrated frequently in the past the housing industry can lead the way out of recession and provide job opportunities in greater quantities than almost any other industry. At a timely hearing on the health of the housing economy last month, the full committee heard evidence that the housing sector is on the rebound with strong vital signs. The patient, however, is not quite out of intensive care.

This week we will explore with our witnesses the steps the subcommittee should take to sustain that recovery, to insure that adequate mortgage money is available at affordable rates, and to insure that we take precautions to hold the price of housing at levels that do not destroy the dream of homeownership for every American.

Second, we will continue to meet this committee's important budget responsibilities, while at the same time compassionately serving low-income families and senior citizens who are ill housed or underhoused. I am pleased to report that the Banking Committee has stated that the assisted housing budget cannot be cut any more. It will work within the framework of the fiscal year 1983 appropriations level. We will, however, continue the work we began last year to develop a housing block grant which, while shortening the length of Federal dependence for assisted housing provides increased flexibility to State and local governments to deal with their own specific housing needs.

In addition, we will deal with the issue of housing affordability versus housing availability with respect to the administration's proposal for a housing payment certificate or voucher.

In my view, these are a few of the crucial issues facing the housing industry during the 98th Congress. I have served on the Banking Committee for all of my Senate career since 1961 and am fully cognizant of the importance of a strong housing industry to a healthy economy. The issues which the subcommittee will address are by no means new to me, and they are ones in which I have taken a strong interest particularly during my years as the ranking minority member from 1971 to 1976, and over an even longer period of time, about 10 years, as the ranking minority member of the Housing and Urban Affairs Subcommittee. During this time I was pleased to cosponsor much landmark legislation in the housing field, with my very distinguished colleague and former chairman, John Sparkman.

As we begin these hearings, we'll move forward to an April 13 of the HUD authorization bill. It is my intention, with the cooperation of my colleagues on the committee, to take every step necessary to see that a bill is enacted into law this year. Last year's stalemate, the first time in recent memory, was unacceptable. I did ask the majority leader for full time for our bill—as soon as his schedule permits, I'll be prepared to meet with Mr. Gonzalez—and enough time to deal with the equitability and effectively with even the toughest legislative differences. My hope is that the House committee will not again entrap themselves into legislative proposals which it cannot even get onto the House floor.

STATEMENT OF SENATOR HEINZ

Senator HEINZ. As you know, Mr. Secretary, S. 586 is a bill to direct the Secretary of Housing and Urban Development to provide Federal matching funds to nonprofit neighborhood organizations which raise voluntary charitable contributions from individual businesses and charitable organizations in their neighborhoods.

Since October of last year when I first introduced this legislation with Senator Hatfield, I have worked with the Neighborhood Coalition, an umbrella organization comprised of more than 40 national groups, the Senate and House Housing Subcommittees, and the additional Senate cosponsors to refine the bill. My staff has also been talking with officials at HUD about the bill.

This new version highlights the two principal objectives of this demonstration project.

One, to achieve tangible improvements in neighborhoods through public/private partnership; and

Two, to foster the long-term self-sufficiency of nonprofit neighborhood development organizations.

It is impprtant to note that the neighborhood organizations must work closely with local government to assure coordination on proposed activities. With this requirement in the bill we have been assured of the endorsement of the National League of Cities and the U.S. Conference of Mayors.

The major strengths of the bill's approach are as follows:

One, the bill would help to leverage additional private sector involvement in lower income communities by providing neighborhood organizations with a pool to use as seed money for development activities.

Two, the proposed legislation builds upon the strengths and successes of established neighborhood development organizations with a proven track record of working with municipal leadership. It does not attempt to create or finance new entities.

Three, the proposed legislation is based upon principles—dear to the President—of private initiative, self-help, and voluntarism. No Federal funds would be disbursed unless neighborhood groups raise charitable donations from residents of their own communities.

Four, the proposed legislation minimizes bureaucratic redtape. It establishes a simple matching process.

Five, the proposed legislation supplements and reinforced other recent initiatives to strengthen economic development in low-income communities. In particular, the proposed bill reinforces the emphasis on neighborhood-based economic development in the Enterprise Zone proposals and provides an added incentive for charitable giving by lower income nonitemizing taxpayers.

The Neighborhood Development Demonstration Act would authorize several hundred demonstration projects over 3 years in distressed areas.

Selection of neighborhood groups would be based on:

One, the past accomplishments of the applicants.

Two, the tangible results expected by the applicants; as well as geography, community population, size, and neighborhood economic conditions.

Eligibility would require nonprofit status, a representative Government board, location in pockets of poverty, and a plan to coordinate with local government.

The maximum grant would be $50,000 in 1 year seed money. The ratio of Federal money to match locally raised funds would vary according to need.

I must reemphasize for the record, that the ultimate purpose of this bill is to encourage voluntarism and public/private partnership on behalf of better neighborhoods.

Several States (including Pennsylvania and Missouri) have enacted Neighborhood Assistance Act legislation which provides tax breaks for neighborhood development contributions by State businesses.

This initiative at the Federal level would directly dovetail with those State programs and others aimed at improving neighborhoods.

This program would require an authorization of only $15 million for the entire 3-year demonstration. This is a small price tag for the improvement of a valuable national asset: The neighborhoods of our Nation's cities.

Mr. Chairman, before asking the Secretary of HUD's reaction to this initiative, I would like to ask unanimous consent that statements by the Neighborhood Coalition and Aetna Life and Casualty's National Urban Neighborhood Investment program be included in the hearing record. (See p. 199.)

STATEMENT OF SENATOR PAULA HAWKINS

Senator **Hawkins**. Mr. Chairman, I commend you for calling these hearings at this early date. It is essential that Congress pass this year legislation to reauthorize the Housing and Community Development programs. A continued upturn in housing construction is essential for our economic recovery. You have my full support in your effort to push a housing bill through the Banking Committee this April.

I support the administration's objectives to provide cost effective housing for the most needy in our society and to assist the local communities in their economic development activities. I feel that it is important to bring the private sector into a more prominent role of supplying housing for all Americans.

I am pleased that HUD is recommending the continuation of the community development block grant and urban development action grant programs. These programs are cost effective and give the local communities the flexibility to meet their housing and economic development needs.

It is gratifying that HUD is proposing to continue the section 202 direct loan program which has been successful in meeting the housing needs of the elderly. Our senior citizens comprise a group in the most need of housing assistance.

HUD's efforts to make better use of the Nation's existing housing stock and to increase the number of persons benefiting from the low-income housing program is encouraging. The proposal for a market approach through a housing payment certificate is an intriguing one that I will be examining very carefully.

STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. Mr. Chairman, Secretary Pierce and my colleagues, as the newest member on this side of the aisle, I look forward to this, my first opportunity to hear the legislative proposals of HUD.

As a freshman, Mr. Secretary, I have been observing the process here and pondering our mutual responsibilities to citizens of New Jersey. As their representative in this committee, the needs of my State are upper most in my mind. You, too, Mr. Secretary, represent New Jersey as you do all States as an appointee of the President.

New Jersey, as yesterday's Washington Post notes, contains the poorest city in the Nation and another one—Paterson, where I grew up—in the top five. I know that the meaning of that ranking is not lost in either of us. There are all too many citizens in my State in need of shelter and relief from rent burdens which tax their ability to provide the other essentials of life.

I will be closely examining your proposals to see if they are adequate in terms of the need in New Jersey and across the Nation and fair in terms of their impact on those most in need.

It is my hope that we can work together to relieve the anxiety that unemployment has brought to those fearful of losing their homes and their hope. I want to work with you to develop programs for the future which meet the needs of a changing population.

Thank you and welcome.

Senator TOWER. Our first witness this morning is the Honorable Samuel R. Pierce, Secretary of Housing and Urban Development.

Mr. Secretary, we would hope that you would summarize your statement. We will, of course, include your full statement in the record, so that it will be available for all to see. But in the interests of time, if you could summarize your statement to give us more time for questions, we would be grateful.

Mr. Secretary, you may proceed as you see fit. Following your testimony, we will take questions from the members.

STATEMENT OF SAMUEL R. PIERCE, JR., SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary PIERCE. Mr. Chairman, I should like to submit a written statement for the record and make some remarks at this time.

Mr. Chairman, my testimony today will present the Department's legislative program for fiscal year 1984.

First, I would like to outline the goals we are pursuing on behalf of this administation and the American people, as well as the methods we are employing to achieve them.

Our goals are, one, to provide cost-effective housing for the most needy in our society; two, to further equal housing opportunity and work toward elimination of discriminatory, practices, and to promote equal opportunity in all housing, community and economic development opportunities; three, to encourage home ownership; and, four, to assist in the development of stronger communities, while delegating to State and local governments greater responsibility for planning and operating their own community and economic development activities.

SIGNS OF PROGRESS

We have made important progress toward these goals. Here are some of the signs of that progress. FHA activity has hit an historic high. We had the greatest number of actual applications ever filed, in November, December and January, for an annualized rate of over 1 million applications in each of those months. We have continued the successful role of GNMA, which provides more than three-fourths of the financing for all VA and FHA mortgages. The UDAG program has been redirected to stimulate economic development and create new jobs, in the past 2 years, when 90,000 new jobs were created, 24,000 jobs were retained and $4.5 billion in private funds invested in distressed cities. The CDBG program was revised to allow greater local flexibility for economic development activities, and the small cities program is being run successfully in the States which have opted to administer their own programs.

We developed the joint venture for affordable housing to bring the cost of a home more in line with the budget of the American family. Housing costs can be reduced when builders and developers cooperate with State and local governments to reduce unnecessary operations, streamline processes and encourage the kinds of housing needed for today's smaller and more diverse households. We've already documented savings of as much as 20 percent on the cost of a new home. We have advanced further in meeting our fair housing and equal opportunity objectives, and have expanded upon the way we approach these issues.

In the past 2 years the number of State and local agencies authorized to process fair housing complaints has increased from 38 to 69 on the voluntary side, to assist us in monitoring evaluating affirmative marketing agreements. We have increased the number of community housing resource boards in the last 2 years by 44 percent. We are encouraging and establishing greater minority business and black college participation in the whole range of HUD activities. In fiscal year 1982 alone, we awarded over $1 million in contracts and grants to historically black colleges and universities.

Indeed, we have made progress.

Our legislative proposals for fiscal year 1984 have helped us to continue our progress and can extend assistance to even more of those whose housing needs have yet to be met. Through extensive research and program experience, we know now that the single most prevalent housing problem of the poor in most communities is affordability, not availability. Good quality housing or housing for which only minor repairs are necessary is widely available, but it costs too much for those we need to serve. That is the problem we must address.

HOUSING PAYMENT CERTIFICATES

We propose housing payment certificates which help poor people afford good housing in the broader community. This proposal is the most humane, most socially positive and cost-effective housing program we could offer for your consideration. Here's how it works. A housing payment certificate is a piece of paper issued by a local public housing authority to a family or individual eligible for housing assistance. The certificate enables the family to shop for decent, safe and sanitary rental housing and guarantees payment to the landlord for a portion of the rent. The certificate offers a shopping incentive. The family receiving assistance may choose the amount of its income it desires to spend for shelter, as well as where it wishes to reside. HUD will pay the difference between the 30 percent of the family's adjusted gross income and a reasonable rent level. The family may choose to rent for less than the standard level and pocket the savings or is free to spend more, should it choose to do so.

Housing certificates have a number of advantages. Families can choose where they want to live and can move to less segregated neighborhoods. New construction often perpetuates segregation. Prospective tenants negotiate with landlords just like other families shopping for housing. Certificates can help improve the housing stock. Under the section 8 existing housing program, 75 percent of units failed initial inspections for repair. And made available for low income families, certificates mean a more efficient use of limited Federal funds.

The current costs are running about one-third of that of new construction units.

Finally, we are increasing housing opportunities for lower income families.

If our proposals are accepted, 80,000 additional families will receive housing assistance through existing housing stock in fiscal year 1984. Existing housing is the most efficient and the quickest way we can provide housing assistance to the poor.

An adequate level of private investment in multi-family housing is necessary to make this system work, and our legislative initiatives will help the private sector make that investment. Of course, in some cases, direct support for construction and rehabilitation of housing is needed. We offered several proposals to address these cases to make better use of the Nation's existing supply of rental units and to provide low income family housing assistance.

We are resubmitting our proposal for a rental rehabilitation program. We propose a funding level of $150 million to rehabilitate approximately 30,000 rental units. The rental rehab program is designed to leverage private investment, allow more local level decisionmaking and provide housing units for certificate participants, all at less cost to taxpayers. Local governments will target assistance to low-income neighborhoods, where at least 80 percent of the rehab units will be affordable and available for very low-income families assisted through housing certificates.

Some communities may need new construction. We propose to help meet this need by allowing residential new construction as an eligible activity of the community block grant program. Such new housing will be targeted in accordance with the program's objectives. We anticipate that the use of CDBG funds for new construction will occur only where there is exceptional need and where local governments are using or seeking additional ways to solve their communities' housing problems.

We know it's difficult for our elderly and handicapped citizens to get safe and affordable housing, especially on a fixed income. We propose continuing the section 202 direct loan program, which has been very successful in meeting our needs. Our fiscal year 1984 budget requests $476 million in loan authority for about 10,000 new units for the elderly or handicapped. The elderly will also participate in the proposed certificate program, and the shared housing concept supported by many elderly groups can be accommodated under it.

We also propose providing mortgage insurance to manufactured home parks which are exclusively for elderly occupancy.

INDIAN HOUSING PROGRAM

Early on, I made a commitment to address the significant and unique problems of Indian housing on reservations and engaged in wide-ranging discussions within the administration on that issue. To meet Indian housing needs, our 1984 legislative package includes a major initiative based on two primary programs, an Indian housing program and the Indian community development block grant program. The cornerstone of the Indian housing program will be the use of single-family FHA insurance. This insurance will make ownership available to Indians who do not presently have access to private financing, due to the unique status of Indian trust lands.

HUD is also requesting an authorization of $76 million in budget authority for its Indian housing program. These funds will be used to facilitate the construction and supporting infrastructure needs of 1,500 homes and to make certificates available for very low-income families. Specifically, the program will allow a breakdown of capital costs to insure that low-income families will be able to afford their monthly mortgage payments. In addition, very low-income families will be allowed to rent newly constructed units through the use of housing maintenance certificates tied to those units for a 15-year period.

The Indian community block grant is the second program, and it will be funded from the President's Discretionary Fund. We would increase that fund by $44 million with new construction becoming an eligible activity for a total funding level of $75 million to Indian tribes. This is the first time that funds will have been earmarked specifically for Indians in the CDBG program. If the entire $44 million increase were used for new construction, we estimate approximately 1,500 new units could be provided, in addition to those provided under the housing program.

Of course, tribes would be able to use these grants for all activities currently eligible under CDBG. In short, tribes would have a full range of options in using funds from both proposed programs to meet their housing and community needs.

Public housing in this country is a valuable resource, and we are committed to make the best use of it for low-income families. I propose to improve public housing by putting into the hands of public housing directors, both the funds they need to maintain, and improve their projects and the flexibility they need to make the most of those funds. I propose a single grant to cover both operating costs and replacement reserves to keep housing structures in good condition. To determine the amount needed for the combined grant to each housing authority, we have looked at the amount private owners of rental housing use to operate, maintain, and improve their properties. Under our proposal we will adopt that system for our public authorities, using the section 8 existing fair market rents as the basis for determining the maximum subsidy.

Using fair market rents for public housing will insure that over time public housing funding reflects changes in the costs of providing people with rental housing. It will enable public housing authority directors to manage their projects well on the basis of assured and flexible funding amounts.

I recognize, of course, that the public housing stock still has a backlog of repair and replacement needs, and I have included $3.5 billion in my budget over the next 4 years for transition modernization added to amounts already appropriated. These transition modernization funds are intended to repair the public housing stock and make it more energy efficient. Housing authorities will receive transition modernization funds at the same time they'll be receiving a combined grant for operating subsidies and replacement needs. This will enable them to build up reserve for future repairs and improvements, as well as maintain their housing projects in good condition in the future.

This administration believes that the role of the FHA in the future should be to provide mortgage credit to those unserved or underserved by the private market and that FHA should resume its role as a market innovator. Many of this year's legislative initiatives will make mortgage credit more affordable by low- and moderate-income families and first-time home buyers by eliminating program restraints and constraints, reducing monthly payments during the early years of the mortgage or by other means.

ALTERNATIVE MORTGAGE INSTRUMENTS AVAILABLE

In addition to several alternative mortgage instruments already available under FHA, which include graduated payment mortgages, shared equity mortgages, we propose authorization for FHA to insure adjustable rate mortgages and shared appreciation mortgages for single-family housing.

We also propose eliminating the special conditions of existing law which limit the availability of mortgage insurance for individual condominium units and increased loan limits for manufactured homes and lots under the title I insurance program.

This will expand homeownership options for low- and moderate-income families. Through these activities, FHA will support homeownership of all types—for those in single-family housing, condominiums, and manufactured housing.

I also propose extending the use of graduated-payment mortgages and share appreciation mortgages to multifamily programs.

We intend to make multifamily programs more attractive so they will continue to provide an FHA insurance resource in those communities where the private sector needs additional help.

Finally, I propose that interest rates on virtually all FHA mortgage loans be negotiated between the borrower and the lender, without the administrative interest rate ceiling required by present law.

Consistent with our goal to assist the development of viable communities, we're seeking a 3-year authorization of $3.5 billion each year for community development block grant programs in the fiscal years 1984, 1985, and 1986. This authorization level will provide the same level of support as in 1983 for community development activities under both the entitlement and State small cities program.

In addition, as mentioned previously, we seek an increase in the level of CDBG assistance for Indian tribes.

The State small cities block grant program is working well. States have developed their programs in a variety of ways to meet their communities' needs.

One highlight is the way States are using the program to expand opportunities for new jobs and to establish new linkages with the private sector.

During fiscal year 1983, we expect as many as 48 of the 50 States, plus Puerto Rico, to operate the program. We are there proposing mandatory State administration of this program.

Considering such wide participation by States, it is increasingly less cost-effective for HUD to maintain a standby capability in areas of rulemaking, staffing, training, and travel.

We also request a 3-year authorization of $196 million in fiscal year 1984 and $440 million each year in fiscal years 1985 and 1986 for the urban development action grant program.

The reauthorization requests, together with funds deferred from 1983, would provide a constant funding level of $440 million for severely distressed cities and urban counties during this period.

The Department has proposed a legislative amendment to require that all cities with populations of under 50,000 apply for urban development action grants from the 25-percent set-aside fund now reserved for small cities which are not central cities in an NSA.

This will make competition more equitable, by placing cities of similar size and capacity in the same category for funding purposes.

The Department seeks reauthorization and expansion of the urban homesteading program in 1984. A $12 million program is proposed, with a multifamily component of $3 million. This program has successfully utilized existing housing stock to provide homeownership and has resulted in the preservation and revitalization of many neighborhoods.

Under our proposal, localities would have the flexibility to transfer multifamily properties with five or more dwelling units.

Abandonment of small rental properties is a particularly serious problem in many localities, and a transfer of these multifamily properties to homesteading use would alleviate this problem.

As the President stated in his State of the Union address, I hope we can work together to create new incentives for jobs and opportunity.

In this light, the administration is proposing, in a separate package, enterprise zone legislation, which focuses on dealing with the economic distress of our Nation's cities. The purpose of the program is twofold:

To create jobs in depressed areas, particularly jobs for disadvantaged workers and long-term unemployed individuals;

And to redevelop and to revitalize the zone areas themselves.

Under the proposed legislation, a maximum of 75 zones will be approved during the first 3 years of the program. At least one-third of these zones will be in the rural areas.

Enterprise zones offer long-term hope for job creation and revitalization of distressed cities and rural towns.

This legislation will not be before your committee. Its subject matter is so pertinent to your concerns I urge you to encourage expedited action by the Finance Committee and the Senate on the administration's bill.

Mr. Chairman, this concludes my remarks. I look forward to working with you and your committee to achieve early passage of an authorization bill this year.

[The complete statement of Mr. Pierce follows.]

STATEMENT OF
SECRETARY SAMUEL R. PIERCE, JR.
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

INTRODUCTION

MR. CHAIRMAN, I AM PLEASED TO APPEAR BEFORE THE SUBCOMMITTEE TODAY AND TO PRESENT THE FISCAL YEAR 1984 LEGISLATIVE PACKAGE FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

THE KEY OBJECTIVES OF THE DEPARTMENT ADDRESSED IN MAJOR PROVISIONS OF OUR SUBMISSION ARE:

-- TO PROVIDE COST EFFECTIVE HOUSING FOR THE MOST NEEDY IN OUR SOCIETY,

-- TO ENSURE FAIR HOUSING AND EQUAL OPPORTUNITIES,

-- TO ENCOURAGE HOMEOWNERSHIP; AND

-- TO ASSIST IN THE DEVELOPMENT OF STRONGER COMMUNITIES WHILE DELEGATING TO STATE AND LOCAL GOVERNMENTS GREATER RESPONSIBILITY FOR PLANNING AND OPERATING THEIR OWN COMMUNITY AND ECONOMIC DEVELOPMENT ACTIVITIES.

HOUSING FOR LOW INCOME FAMILIES: THE CERTIFICATE APPROACH

PRIOR TO 1981, THE FEDERAL GOVERNMENT SOUGHT TO SOLVE THE PROBLEMS OF PROVIDING HOUSING FOR THE POOR MAINLY BY CONSTRUCTING NEW BUILDINGS, UNDER THE ASSUMPTION THAT THE PROBLEM WAS A SHORTAGE OF HOUSING. BIPARTISAN RECOGNITION OF THE FAILURES OF THE SECTION 8 NEW CONSTRUCTION PROGRAM HAS TRIGGERED A SEARCH FOR BETTER WAYS TO HOUSE THE POOR.

Based on extensive research and program operation, we believe that in most communities the major housing problem of the poor is housing affordability, not housing availability. Good quality housing, or housing on which only minor repairs are necessary, is widely available, but it costs too much to be affordable to the poor.

Rather than addressing the housing needs of the poor through a large and costly housing production program, we are proposing a program which addresses the issue of affordability of housing for the poor. Our proposal for Housing Payment Certificates helps poor people afford good housing in the broader community, not isolated in projects. We consider this proposal the most humane, most socially positive and cost-effective means of meeting the shelter needs of our nation's poor.

The concepts behind the certificate program are straight-forward:

o A Housing Payment Certificate is a piece of paper issued by a local public housing authority to a family or an individual eligible for housing assistance.

o The certificate enables the family to shop for decent, safe and sanitary rental housing and guarantees payment to the landlord for a portion of the rent.

o The certificate offers a "shopping incentive." The family receiving assistance may choose the amount it desires to spend for shelter, as well as where it wishes to reside. HUD will pay the difference between 30% of the family's adjusted gross income and a reasonable rent level for a given area. The family may choose to rent for less than this standard level and pocket the savings, or it is free to spend more, should it so choose.

We believe our proposal for Housing Payments Certificates has a number of advantages over other approaches.

Certificates allow families to choose where they want to live rather than forcing them into certain buildings. HUD's research shows that, while the population in new construction projects mirrors the racial composition of surrounding neighborhoods, (in some cases perpetuating segregation), families have used certificates to move to less segregated neighborhoods. Because rent levels are subject to negotiation between prospective tenants and their landlords, tenants are treated like other families shopping for housing.

Certificates can also have an effect on improving the housing stock. HUD program evaluations found that under the current Section 8 Existing Housing Certificate program, approximately 50 percent of the units selected failed initial inspections. About 75 percent of those units were repaired (at costs less than $200 per unit) and made immediately available for low-income families.

Certificates are a much less expensive way of providing housing assistance to low-income families. A certificate costs about one-third the amount of a newly constructed unit ($167 per month a unit compared to $450). Thus, certificates mean more efficient use of limited Federal funds.

Finally, let me emphasize that under this program we would increase housing opportunities for lower-income families. We would increase the number of families receiving housing assistance through existing housing stock by 80,000 in fiscal year 1984.

We are convinced that relying on existing housing is the most expeditious and efficient way of providing housing assistance for the poor. This approach, moreover, recognizes the need for an adequate level of private investment in multifamily housing and our legislative initiatives will enhance the ability of the private sector to address that need. We also recognize, however, that there are some circumstances in which direct support for construction and rehabilitation of housing is needed. We are therefore offering several proposals to address these circumstances.

Rental Rehabilitation

In order to make better use of the Nation's existing supply of rental housing units and to provide low-income housing assistance, we recognize the need to rehabilitate some of that stock. As a vital part of our legislative package, the Department is resubmitting its proposal for authorizing a Rental Rehabilitation program at a funding level of $150 million to rehabilitate approximately 30,000 rental units. This proposal is an essential element in our program to help produce decent and affordable rental housing for families assisted through housing certificates.

This is a new approach to coordinating production subsidies with rental assistance. In contrast to the Section 8 New Construction program, the Rental Rehabilitation program is designed to leverage private investment, allow more decisionmaking at the local level, minimize Federal intervention and control, and provide housing units for certificate recipients--all at a much lower cost to taxpayers.

THE DESIGN OF THE RENTAL REHABILITATION PROGRAM IS SIMPLE:

- THE FEDERAL GOVERNMENT WILL PROVIDE GRANTS TO STATE AND LOCAL GOVERNMENTS ON A FORMULA BASIS.
- THESE GOVERNMENTS, WILL IN TURN DESIGN THEIR OWN PROGRAMS TO USE THESE GRANTS IN A NUMBER OF WAYS. THEY CAN OPERATE THEIR REHABILITATION ACTIVITIES THROUGH A LOAN PROGRAM OR THEY CAN PROVIDE GRANTS TO SPONSORS FOR REHABILITATING THESE STRUCTURES.
- LOCAL AND STATE GOVERNMENTS MAY CHOOSE TO SUPPLEMENT THEIR FEDERAL RENTAL REHABILITATION FUNDS WITH OTHER FEDERAL MONIES -- FOR EXAMPLE CDBG FUNDS -- OR THEY CAN LEVERAGE PRIVATE INVESTMENT FOR REHABILITATING THESE RENTAL DWELLINGS. IN ANY CASE, LEVERAGING IS ASSURED SINCE RENTAL REHABILITATION SUBSIDIES WILL NOT EXCEED HALF THE COST OF THE REHABILITATION.
- REHABILITATION ASSISTANCE WILL BE TARGETED TO LOW INCOME NEIGHBORHOODS WHERE AT LEAST 80 PERCENT OF THE REHABILITATED UNITS WILL BE AFFORDABLE AND AVAILABLE FOR VERY LOW-INCOME FAMILIES ASSISTED THROUGH THE HOUSING CERTIFICATE PAYMENT PROGRAM.

NEW CONSTRUCTION ACTIVITIES THROUGH COMMUNITY DEVELOPMENT BLOCK GRANTS

FOR SOME COMMUNITIES, RELIANCE SOLELY ON THE USE OF EXISTING HOUSING STOCK MAY NOT ENABLE THEM TO ADDRESS THEIR LOWER INCOME HOUSING ASSISTANCE NEEDS. FOR THESE LOCALITIES, NEW CONSTRUCTION MAY BE NECESSARY IN ORDER TO RESPOND TO SPECIAL LOCAL HOUSING CONDITIONS. ACCORDINGLY, THE DEPARTMENT PROPOSES TO ALLOW RESIDENTIAL NEW CONSTRUCTION AS AN ELIGIBLE ACTIVITY UNDER THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM.

Our proposal is not submitted with the intent of creating a Housing Construction program within the current Community Development Block Grant program. It is simply to permit communities to become directly involved in what they have already been able to do through subgrantees. Thus, cities will be provided flexibility to tailor their housing approaches more effectively to their specific needs, in a manner consistent with our other efforts to reduce prescriptiveness and federal intrusion. Grantees which choose to use some of their block grant funds for new construction would be freed from cumbersome administrative requirements restricting new construction under the current law. New housing undertaken with Community Development Block Grant funds would be targeted in accordance with the objectives of the program.

Meeting the Housing Needs of the Elderly

We are acutely aware of the unique needs of our elderly and handicapped citizens obtaining safe and affordable housing, usually on a fixed income. Therefore, I am proposing a continuation of the Section 202 Direct Loan program, which has been very successful in meeting the housing needs of the elderly. The FY 1984 budget requests $476 million in loan authority for about 10,000 new units for the elderly or handicapped.

In addition, the elderly will participate in the proposed certificate program, and will benefit from the choice of units available under that program. Moreover, the shared housing concept, which many elderly groups support, can be accommodated under the certificate program.

Our legislative proposals also include authority to provide mortgage insurance in connection with the development or rehabilitation of manufactured home parks which are designed, constructed and managed exclusively for elderly occupancy. Recent surveys indicate that about one-third of all manufactured homes are occupied by older persons; however, manufactured home park facilities for elderly homeowners are often in short supply due to a lack of new construction and the phasing-out of older parks. This legislative change would make mortgage credit more readily available for the development or rehabilitation of park facilities for the elderly.

Finally, we have proposed a limited Home Equity Conversion Demonstration Program. This authority will permit us to insure Reverse Mortgages (RMs) and Reverse Annuity Mortgages (RAMs) for elderly homeowners who are "house rich", but "cash poor". The result of these mortgage instruments will be to supplement the monthly incomes of participating homeowners, and be available to meet emergency housing and related needs.

Indian Housing

Early in my tenure at HUD, the significant and unique problems of Indians were brought to my attention. I made a commitment at that time to do something about these problems and engaged in wide-ranging discussions within the Administration about Indian Housing.

Our 1984 legislative package includes two approaches for addressing the Indian Housing and infrastructure needs -- an Indian Housing program and an Indian Community Development Block Grant program.

A cornerstone of the Indian housing program will be the use of single family FHA insurance. This insurance will make homeownership available to Indians who do not presently have access to private financing, as do other Americans, due to the unique status of Indian trust lands.

In addition to this insurance, HUD is requesting an authorization of $76 million in Budget Authority for its Indian Housing program. These funds will be used to facilitate the construction and supporting infrastructure needs of 1500 homes and to make certificates available for very low income families. Specifically, the program will allow a write down of capital costs to ensure that low-income families will be able to afford their monthly mortgage payments. Also, very low-income families will be allowed to rent units through the use of Housing Payment Certificates tied to newly-constructed units.

The second program, the Indian Community Development Block Grant program, will be funded from the Secretary's Discretionary Fund, which would be increased by $44 million, with new construction becoming an eligible activity, for a total funding level of $75 million to Indian tribes. This is the first time that funds will have been earmarked specifically for Indians in the Community Development Block Grant program. We estimate that if the entire increased amount -- $44 million -- were used for new construction, approximately 1500 new units could be provided in addition to those provided under the housing program.

Tribes would be able to use these grants to fund all of the activities currently eligible under Community Development Block Grants such as rehabilitation, economic development, and various public improvement efforts. As in the Community Development Block Grant program for other grantees, tribes would be able to use block grant funds to provide various forms of assistance. For example, funds could be used to finance "buy-downs" of mortgage interest rates, to provide water and sewer facilities and to make grants.

In short, tribes would have a full range of options in using funds from both proposed programs to meet their housing and community development needs.

Public Housing

Public Housing in this country is a valuable resource and the Department is committed to enhancing this resource for low-income families. Consistent with my desire to maximize the efficient use of existing housing, HUD has carefully reviewed its manner of administering the Public Housing program and proposes a new funding system.

Operating costs for public housing authorities have increased from $28 million in 1970 to the almost $1.3 billion required in Federal operating subsidies in 1983. The current PFS formula has been employed since the mid-1970's. Unfortunately, use of the formula has not led to its intended results. Because it is based on historical costs, the formula has rewarded inefficiencies. Also, even with the enormous increase in funding for Operating Subsidies Public Housing Authorities have not been able to manage both the day-to-day demands of their projects and take care of the repairs and replacements needed for the smooth operation of any project.

The approach I am proposing for improving public housing -- for making it a good place for people to live and keeping it that way -- is to put into the hands of public housing directors both the funds they need to maintain and improve their projects and the flexibility they need to make the most of those funds. Instead of a modernization program separate from operating subsidies, HUD proposes a single grant to

EACH HOUSING AUTHORITY. THIS GRANT WOULD COVER BOTH OPERATING COSTS AND THE FUNDING NEEDED FOR MAINTENANCE, ROUTINE REPAIRS, AND MAJOR REPAIRS AND REPLACEMENTS THAT MUST BE MADE TO HOUSING STRUCTURES TO KEEP THEM IN GOOD CONDITION AS THEY GROW OLDER.

TO DETERMINE THE AMOUNT NEEDED FOR THE COMBINED GRANT TO EACH HOUSING AUTHORITY, WE HAVE LOOKED OUTSIDE THE CURRENT PATTERNS OF SPENDING ON PUBLIC HOUSING AND LOOKED INSTEAD AT THE AMOUNT PRIVATE OWNERS OF RENTAL HOUSING USE TO OPERATE, MAINTAIN AND IMPROVE THEIR PROPERTIES. WE KNOW THAT IN THE RENTAL MARKETPLACE THE RENTS CHARGED BY OWNERS REFLECT THE COSTS OF MORTGAGE PAYMENTS, ROUTINE MAINTENANCE, CAPITAL RELACEMENTS AND A RETURN ON INVESTMENTS. UNDER OUR PROPOSED SYSTEM WE WILL ADAPT THAT SYSTEM FOR OUR PUBLIC HOUSING AUTHORITIES, USING THE SECTION 8 EXISTING FAIR MARKET RENTS (WHICH ARE THE SAME AS THE PAYMENT STANDARDS FOR THE NEW HOUSING PAYMENT CERTIFICATE PROGRAM) AS THE BASIS FOR DETERMINING THE MAXIMUM SUBSIDY.

FAIR MARKET RENTS ARE SET ON THE BASIS OF EXTENSIVE SURVEY DATA ABOUT LOCAL HOUSING CONDITIONS AND CHANGES IN MARKET RENTS. USING FAIR MARKET RENTS FOR PUBLIC HOUSING WILL REDUCE THE LIKELIHOOD OF BUDGET DISPUTES, REQUESTS FOR SUPPLEMENTAL APPROPRIATIONS, AND OTHER PROBLEMS WHICH HAVE PLAGUED THE CURRENT FUNDING SYSTEM. PUBLIC HOUSING AUTHORITY DIRECTORS, FOR THEIR PART, WILL BE ABLE TO MANAGE THEIR PROJECTS WELL ON THE BASIS OF ASSURED AND FLEXIBLE FUNDING AMOUNTS.

I RECOGNIZE, OF COURSE, THAT THE PUBLIC HOUSING STOCK STILL HAS A BACKLOG OF REPAIR AND REPLACEMENT NEEDS WHICH HAVE RESULTED FROM A SYSTEM IN WHICH PUBLIC HOUSING AUTHORITIES HAVE NOT AUTOMATICALLY RECEIVED FUNDS TO MEET THESE NEEDS. THAT IS WHY MY BUDGET INCLUDES $3.5 BILLION OVER THE NEXT FOUR YEARS FOR TRANSITION MODERNIZATION. ADDED TO AMOUNTS ALREADY APPROPRIATED, THESE TRANSITION MODERNIZATION FUNDS ARE INTENDED TO REPAIR THE PUBLIC HOUSING STOCK, WHERE FEASIBLE, AND TO MAKE IT MORE ENERGY EFFICIENT. THE LATTER IS ESPECIALLY IMPORTANT, SINCE ENERGY COSTS CONTRIBUTE SIGNIFICANTLY TO HIGH OPERATING COSTS IN MANY PUBLIC HOUSING PROJECTS.

AT THE SAME TIME THAT THIS TRANSITION MODERNIZATION PROGRAM IS AVAILABLE, HOUSING AUTHORITIES WILL ALREADY BE RECEIVING A COMBINED GRANT FOR OPERATING SUBSIDIES AND REPLACEMENT NEEDS. THEY WILL, THEREFORE, BE ABLE TO BUILD UP RESERVES FOR FUTURE REPAIRS AND IMPROVEMENTS AND BE ABLE TO MAINTAIN THEIR HOUSING PROJECTS IN GOOD CONDITION IN THE FUTURE.

THIS REFORM OF PUBLIC HOUSING FUNDING IS NOT A BUDGET-CUTTING EXERCISE. AS A MATTER OF FACT, WE ARE ASKING FOR MORE MONEY THAN WE WOULD HAVE FOR THE OLD PERFORMANCE FUNDING SYSTEM FOR OPERATING SUBSIDIES. AFTER SEVERAL YEARS, THE NEW FUNDING SYSTEM WILL START SAVING MONEY COMPARED WITH A CONTINUATION OF SEPARATE OPERATING SUBSIDIES AND MODERIZATION PROGRAMS. I AM WILLING TO ASK YOU FOR THESE EXTRA FUNDS AT THE OUTSET BECAUSE I FIRMLY BELIEVE THAT THIS REFORM WILL RESULT IN BETTER PUBLIC HOUSING FOR THE FAMILIES WHICH LIVE THERE.

NEW DIRECTIONS FOR FHA

THIS ADMINISTRATION BELIEVES THAT THE ROLE OF THE FHA IN THE FUTURE SHOULD BE TO PROVIDE MORTGAGE CREDIT TO THOSE WHO ARE UNSERVED OR UNDERSERVED BY THE PRIVATE MARKET, AND TO RESUME ITS ROLE AS AN INNOVATOR IN THE HOUSING MARKET.

IN OUR SINGLE-FAMILY INSURANCE PROGRAMS WE ARE TARGETING FHA TOWARD THESE PEOPLE -- THAT IS, LOW- AND MODERATE-INCOME FAMILIES, FIRST-TIME HOMEBUYERS, AND THOSE INTERESTED IN PURCHASING IN INNER CITY AREAS.

MANY OF THIS YEAR'S LEGISLATIVE INITIATIVES ARE DIRECTED TOWARD MAKING MORTGAGE CREDIT MORE AFFORDABLE BY LOW AND MODERATE INCOME FAMILIES AND FIRST-TIME HOMEBUYERS -- BY ELIMINATING PROGRAM CONSTRAINTS OR REDUCING MONTHLY PAYMENTS DURING THE EARLY YEARS OF THE MORTGAGE, OR OTHER MEANS.

FOR EXAMPLE, ONE OF OUR LEGISLATIVE PROPOSALS WILL LOWER DOWNPAYMENTS FOR THOSE MOST IN NEED OF MODEST-COST HOUSING.

SEVERAL ALTERNATIVE MORTGAGE INSTRUMENTS SUCH AS GRADUATED PAYMENT MORTGAGES (GPMS), SHARED EQUITY MORTGAGES (SEMS), AND GROWING EQUITY MORTGAGES (GEMS) ARE ALREADY AVAILABLE UNDER THE FHA. WE PROPOSE EXPANDING THESE EXISTING MORTGAGE PLANS WITH OTHERS TO MAKE FINANCING MORE READILY AVAILABLE AND AFFORDABLE, PARTICULARLY TO THOSE TARGET GROUPS NOT WELL SERVED BY THE PRIVATE SECTOR.

INCLUDED IN MY PROPOSALS ARE THE FOLLOWING:

o PERMANENT AUTHORITY TO INSURE ADJUSTABLE RATE MORTGAGES (ARMS) FOR SINGLE FAMILY HOMES, WHERE THE MORTGAGE INTEREST RATE IS ADJUSTED ANNUALLY IN ACCORDANCE WITH A NATIONAL INDEX. UNDER CURRENT PRACTICE, USE OF THIS INSTRUMENT GENERALLY RESULTS IN REDUCED INITIAL INTEREST RATES FOR HOMEBUYERS.

- Authority to insure Shared Appreciation Mortgages (SAMs) for single-family housing, in which the lender reduces the interest rate in return for a share in any future appreciation in the property's value. In addition, homebuyers may take advantage of the generally lower interest rates available when the mortgage term is less than 30 years.

- Eliminating the special conditions of existing law which limit the availability of mortgage insurance for individual condominium units. Presently, HUD may insure such units only if the project is more than a year old, or was FHA-insured when constructed, or has been VA-approved, or has less than 12 units. In addition, the unit must be acquired for the borrower's own use or occupancy, and not more than four insured units may be owned by any borrower. Eliminating these conditions will result in expanded homeownership opportunities in condominium development and will also simplify the processing requirements.

- Authority to co-insure mortgages for the purchase and construction of single-family "shell homes," in which homebuyers contribute their own labor to the completion of their homes in order to reduce the mortgage amount and make homeownership more affordable.

- Increased loan limits for manufactured homes and lots under the Title I insurance program, thereby expanding the homeownership options for low- and moderate-income families. The maximum loan limit would be increased to $40,500 for both single-wide and double-wide manufactured homes, $13,500 for lots. This $54,000 combination for loans and lots could be increased by up to one-third, in order to benefit areas where the higher costs of land acquisition and site development are the major factors limiting the use of the Title I program.

THROUGH THESE ACTIVITIES, FHA WILL SUPPORT HOMEOWNERSHIP OF ALL TYPES--FOR THOSE IN SINGLE-FAMILY HOUSES, IN CONDOMIMIUMS AND IN MANUFACTURED HOUSING.

I PREVIOUSLY MENTIONED IN MY TESTIMONY THAT WE EXPECT TO ENHANCE THE AVAILABILITY OF MULTIFAMILY MORTGAGE CREDIT, GIVEN THE ENACTMENT OF SOME OF OUR LEGISLATIVE INITIATIVES. IN THIS REGARD, SEVERAL OF THE MORTGAGE INSTRUMENTS PROPOSED FOR SINGLE-FAMILY HOMEBUYERS WILL ALSO BE MADE AVAILABLE FOR MULTIFAMILY DEVELOPMENT. IN THIS REGARD, I AM PROPOSING EXTENDING THE USE OF GRADUATED MORTGAGE PAYMENTS AND SHARED APPRECIATION MORTGAGES TO MULTIFAMILY PROGRAMS. WE INTEND TO MAKE MULTIFAMILY PROGRAMS MORE ATTRACTIVE, PARTICULARLY IN THOSE COMMUNITIES WHICH NEED NEW HOUSING AND WHERE THE PRIVATE SECTOR NEEDS THE ADDITIONAL HELP THAT CAN COME OUT OF FHA INSURANCE AND THE SECONDARY MORTGAGE MARKETS THAT IT BRINGS WITH IT.

I SHOULD NOTE THAT OUR EFFORTS IN MANY CASES LOOK TO THE PRIVATE MARKET FOR EXAMPLES OF EFFICIENCY. IN THIS REGARD, AND AS PART OF THIS REDIRECTION EFFORT FOR FHA, I AM PROPOSING THAT INTEREST RATES ON VIRTUALLY ALL FHA MORTGAGE LOANS BE NEGOTIATED BETWEEN THE BORROWER AND THE LENDER, WITHOUT THE ADMINISTRATIVE INTEREST RATE CEILING REQUIRED BY PRESENT LAW.
OVER THE YEARS, THE PERCEPTION HAS DEVELOPED THAT, BY SETTING A CEILING, FHA DETERMINES OR CONTROLS INTEREST RATES. THIS IS SIMPLY NOT THE CASE. FHA MORTGAGES, LIKE OTHER MORTGAGES, ARE SOLD TO INVESTORS AT MARKET YIELDS, AND THESE INVESTORS DISCOUNT THE LOANS TO INCREASE THE YIELD TO THAT AVAILABLE ON ALTERNATIVE INVESTMENTS. THESE DISCOUNT "POINTS" CANNOT LEGALLY BE CHARGED DIRECTLY TO THE BORROWER; RATHER, THEY ARE PASSED ON INDIRECTLY, IN THE SALES PRICE CHARGED BY THE SELLER. THE CHANGE I AM PROPOSING WILL PERMIT THE LENDER AND THE BORROWER TO NEGOTIATE THE INTEREST RATE, AND WILL ELIMINATE THE NEED FOR THE BUILDER OR SELLER TO PAY THESE EXCESSIVE DISCOUNT POINTS IN ORDER TO CLOSE THE GAP BETWEEN ACTUAL MARKET RATES AND THE FHA CEILING.

FAIR HOUSING AND EQUAL OPPORTUNITY

FAIR HOUSING AND EQUAL OPPORTUNITY IS SOMETHING TO WHICH I AM PERSONALLY COMMITTED AND THE DEPARTMENT INTENDS TO CONTINUE ITS SYSTEMATIC EFFORTS TO INSURE EQUAL OPPORTUNITY AND FAIR HOUSING IN FISCAL YEARS 1983 AND 1984.

THE DEPARTMENT IS ACTIVELY WORKING TO ELIMINATE DISCRIMINATION IN THE HOUSING MARKET. SINCE THE ADMINISTRATION TOOK OFFICE, MORE THAN $5 MILLION HAS BEEN PROVIDED TO STATE AND LOCAL GOVERNMENTS FOR THEIR ENFORCEMENT OF FEDERAL HOUSING OBJECTIVES. THERE HAS BEEN A MARKED INCREASE IN STATE AND LOCAL PROCESSING OF FAIR HOUSING COMPLAINTS AND THE NUMBER OF STATES AND LOCAL AGENCIES RECOGNIZED BY HUD — AS HAVING ESSENTIALLY EQUIVALENT FAIR HOUSING CODES TO TITLE VIII — HAS INCREASED FROM 38 TO 69, WITH SEVERAL MORE EXPECTED TO ENTER THE PROGRAM IN THE NEAR FUTURE.

OUR ADMINISTRATION RECOGNIZES THAT A BALANCED VOLUNTARY AND STATUTORY PROGRAM FOR DEVELOPING AND ENFORCING THE NATION'S FAIR HOUSING STANDARDS WILL ULTIMATELY MEET WITH THE GREATEST SUCCESS. THEREFORE, HUD HAS MOVED TO INCREASE LOCAL VOLUNTARY ACTIONS THROUGH THE EXPANSION OF THE NUMBER OF COMMUNITY HOUSING RESOURCE BOARDS BY 44 PERCENT IN THE LAST TWO YEARS. THESE BOARDS ASSIST THE DEPARTMENT IN MONITORING AND EVALUATING AFFIRMATIVE MARKETING AGREEMENTS WHICH MEMBERS OF THE HOUSING INDUSTRY HAVE SIGNED. WE HAVE SUCCEEDED IN INCREASING THE NUMBER OF PARTICIPATING LOCAL REALTOR ASSOCIATIONS BY NEARLY ONE-THIRD IN THE LAST TWO YEARS. FURTHER, WE ARE CONTINUING TO IMPROVE THE PROCESSING OF INDIVIDUAL AND SYSTEMIC COMPLAINTS OF HOUSING DISCRIMINATION. IN ADDITION, WE BELIEVE THE ESTABLISHMENT OF OUR CERTIFICATE PROGRAM WILL EXPAND FAIR HOUSING OPPORTUNITIES BY PROVIDING GREATER CHOICE IN THE TYPE AND LOCATION OF HOUSING. THE DEPARTMENT WILL CONTINUE TO SEEK ADDITIONAL MEANS TO ENFORCE OUR NATION'S FAIR HOUSING LAWS.

Emphasis will also continue to be placed by HUD on helping minority colleges and businesses to participate in Federal, state and local government activities. For example, awards to small and disadvantaged businesses in 1983 will increase by 13.4 percent over 1982. HUD continues to be the top-ranking Federal agency in terms of deposits with minority banks.

I have also taken action to assist historically Black colleges by increasing their awareness of government procurement processes, by awarding to them over $1 million in contracts and grants in FY 1982 alone, and by awarding 11 competitive grants to highly qualified Black colleges and universities so that they can deliver needed technical assistance to their communities.

Community Development

Consistent with our objective of assisting in the development of viable communities, the Department is seeking a three year reauthorization of $3.5 billion each year for the Community Development Block Grant program in Fiscal Years 1984, 1985, and 1986. This authorization level will provide the same level of support as in 1983 for community development activities under both the Entitlement and State Small Cities programs. In addition, as mentioned previously, we seek an increase in the level of Community Development Block Grant assistance for Indian Tribes.

In addition to the previously mentioned community development proposals affecting housing such as Rental Rehabilitation, and New Construction as an eligible activity with Community Development Block Grants, we are also recommending a number of technical changes in the Block Grant program. We believe these changes will improve the efficiency and capacity of the Block Grant program to assist localities in meeting their community development needs, foster local accountability in the use of Block Grant funds, and correct or avoid problems in the grant allocation and realloction process.

The State Small Cities Block Grant program is working well. States have developed their programs in a variety of ways to meet the needs of their communities. One highlight is the way states are using the Community Development Block Grant program to expand opportunities for new jobs and to establish new linkages with the private sector. Coordination with other Federal and State programs has improved and federal red tape has been reduced. States are actively involving local elected officials in shaping the design and implementation of the program. They are also continuing to use a significant portion of their funds for more traditional activities such as public facilities and housing rehabilitation.

During Fiscal Year 1983 we expect as many as 48 of the 50 States, plus Puerto Rico, to operate the program. We are, therefore, proposing mandatory state administration of this program, recognizing it as a key element in the New Federalism. In light of the wide participation by states, it is increasingly less cost effective for HUD to maintain a standby capability in areas of rulemaking, staffing, training, and travel. With the success of the State program to date and its increasing popularity, it has become clear that it is no longer necessary or appropriate for the Federal government to administer the program as an alternative to state operation.

Urban Development Action Grants

The Department is also requesting a three year authorization of $196 million in Fiscal Year 1984 and $440 million each year in Fiscal Years 1985 and 1986 for the Urban Development Action Grants program. The reauthorization request, together with funds deferred from 1983, would provide a constant funding level of $440 million for distressed cities and urban counties during this period. This funding will promote economic recovery through stimulation of commercial and industrial development.

The Department has proposed a legislative amendment to require that all cities with populations under 50,000 apply for Urban Develoment Action Grants from the 25 percent set-aside fund now reserved for small cities which are not central cities in an MSA. This proposal will make competition for Urban Development Action Grant funding more equitable by placing cities of similar size and capacity in the same category for funding purposes.

The Action Grant program is one of the few federal efforts targeted to distressed cities and to economic development projects in these cities which provide jobs, increase the tax base and result in extensive revitalization. Assistance is available only to communities which qualify on the basis of severe economic distress either for the community as a whole or in a specially designated "Pocket of Poverty." Eligible cities must also have demonstrated results in providing housing for low- and moderate-income persons and equal opportunity in housing. Urban Development Action Grant funds tend to be targeted further with over 60% of grant funds awarded to eligible cities ranking in the top 40% on distress indicators. The Urban Development Action Grant program is the only federal program which requires private financial commitment before federal dollars are spent, thus insuring benefits for distressed cities far in excess of federal funds expended.

URBAN HOMESTEADING

THE DEPARTMENT SEEKS REAUTHORIZATION AND EXPANSION OF THE URBAN HOMESTEADING PROGRAM IN 1984. A $12 MILLION PROGRAM IS PROPOSED, WITH A MULTIFAMILY COMPONENT OF $3 MILLION. THIS PROGRAM HAS SUCCESSFULLY UTILIZED EXISTING HOUSING STOCK TO PROVIDE HOMEOWNERSHIP AND HAS RESULTED IN THE PRESERVATION AND REVITALIZATION OF MANY NEIGHBORHOODS.

THE DEPARTMENT PROPOSES TO BUILD ON THE SUCCESSFUL SINGLE-FAMILY PROGRAM ALLOWED IN ALL COMMUNITIES APPROVED FOR URBAN HOMESTEADING FUNDING. UNDER THIS PROPOSAL, LOCALITIES WOULD HAVE THE FLEXIBILITY TO TRANSFER MULTIFAMILY PROPERTIES WITH FIVE OR MORE DWELLING UNITS. ABANDONMENT OF SMALL RENTAL PROPERTIES IS A PARTICULARLY SERIOUS PROBLEM IN MANY LOCALITIES. TRANSFER OF THESE MULTIFAMILY PROPERTIES UNDER THIS PROPOSAL WOULD ALLEVIATE THIS PROBLEM BY ALLOWING FOR THE DEVELOPMENT OF NEW HOMESTEADING CONCEPTS FOR HUD-HELD AND LOCALLY ACQUIRED MULTIFAMILY PROPERTIES.

ENTERPRISE ZONES

AS THE PRESIDENT STATED IN HIS STATE OF THE UNION ADDRESS, "I HOPE WE CAN WORK TOGETHER..." TO "CREATE NEW INCENTIVES FOR JOBS AND OPPORTUNITY." IN THIS LIGHT, THE ADMINISTRATION IS PROPOSING IN A SEPARATE PACKAGE, ENTERPRISE ZONE LEGISLATION, WHICH FOCUSES ON DEALING WITH THE ECONOMIC DISTRESS OF OUR NATION'S CITIES.

THE PURPOSE OF THE PROGRAM IS TWOFOLD: TO CREATE JOBS IN DEPRESSED AREAS, PARTICULARLY JOBS FOR DISADVANTAGED WORKERS AND LONG-TERM UNEMPLOYED INDIVIDUALS, AND TO REDEVELOP AND REVITALIZE THE ZONE AREAS THEMSELVES.

UNDER THE PROPOSED LEGISLATION, A MAXIMUM OF 75 ZONES WILL BE APPROVED DURING THE FIRST THREE YEARS OF THE PROGRAM. AT LEAST ONE THIRD OF THESE WILL BE FOR RURAL AREAS.

ENTERPRISE ZONES OFFER LONG-TERM HOPE FOR JOB CREATION AND REVITALIZATION OF DISTRESSED CITIES AND RURAL TOWNS. WHILE THIS LEGISLATION WILL NOT BE BEFORE YOUR COMMITTEE, ITS SUBJECT MATTER IS SO PERTINENT TO YOUR CONCERNS THAT I URGE YOU TO ENCOURAGE EXPEDITED ACTION BY THE FINANCE COMMITTEE AND THE SENATE ON THE ADMINISTRATION'S BILL.

MR. CHAIRMAN, THIS CONCLUDES MY PREPARED REMARKS. I LOOK FORWARD TO WORKING WITH YOU TO ACHIEVE EARLY PASSAGE OF AN AUTHORIZATIONS BILL THIS YEAR.

Senator TOWER. Thank you, Mr. Secretary.

Mr. Secretary, FHA does not insure loans on some of the most affordable housing in the housing stock, the older, but still habitable, homes that are found in core cities and, in some instances, in the rural countryside.

The restrictions against these properties appear to be more rigid than those which define acceptable rental housing under the voucher program.

Young families and other low-income families cannot afford a large downpayment required by conventional loans. These homes are often acquired by investment and become rentals.

My question is, Mr. Secretary, many young families want to purchase an older home that they can improve through their own efforts. Yet, FHA will not insure these properties.

Could you supply us, for the record, factors by which a home is evaluated and give us the departmental assessment of the impact of reducing these criteria?

Secretary PIERCE. We will supply that for the record, sir.

[Requested information follows:]

RESPONSE TO QUESTION OF SENATOR TOWER

Question. Many young families want to purchase an older home that they can improve through their own efforts. Yet, FHA will not insure these properties. Could you supply us with the factors by which a home is evaluated and give us the Departmental assessment of the impact of reducing these criteria?

Answer. First I would like to point out that this Department does have a program under Section 223(e) which authorizes mortgage insurance for the repair, rehabilitation, construction or purchase of properties in older, declining urban areas in which conditions are such that one or more of the requirements of Title II cannot be met.

Section 223(e) gives HUD more flexibility in providing financing than under other Sections of Title II. It waives economic soundness and economic life requirements with respect to location and mortgage term if the property is in a location which is reasonably viable, considering the need for housing for low- and moderate-income families and the objective of upgrading older, declining neighborhoods.

All home mortgage properties must be submitted by mortgages for insurance under a standard Section of the Housing Act, usually Sections 203(b) or 221(d)(2). Under these Sections a property must be free of hazards, moxious odors, grossly offensive sights, or excessive noises which might endanger the physical improvements, affect the livability of the property or its marketability, or the health and safety of its occupants. A property must also comply with the code enforcement area. A property must possess sufficient future economic life to warrant a long-term mortgage.

In addition, HUD's Minimum Property Standards for existing housing are already less stringent than those required for new construction; therefore, we do not believe these standards should be reduced any further.

Finally, and most important, you should know that the Department administers a rehabilitation program under Section 203(k) which can be used to finance the rehabilitation of an existing property. I have identified our Section 203(k) single-family program with its provision for including rehabilitation costs in the insured mortgage as a vehicle for serving the inner-cities. This Spring the Department will launch an intensive effort to promote the use of this program in 15 cities. GNMA has estabished a secondary market for the 203(k) program which has already increased activity on this front.

REDUCING MINIMUM DOWNPAYMENT

Senator Tower. The administration is proposing to further reduce the minimum downpayment requirement on FHA loans. This proposal is the centerpiece of HUD's attempt to redirect FHA to the first-time home buyer and the lower income family.

Downpayments would be further reduced, from 3 percent of the first $25,000 to 5 percent of the first $50,000 and 10 percent thereafter.

How do these changes in the downpayment structure for FHA-insured loans affect the actuarial soundness of the insurance costs?

Secretary Pierce. We do not think that it will harm the actuarial conclusions. We believe it will be of help to the younger people who are seeking homes, because so many of them fall into that lower income category and the lower housing cost category.

We think it will be of help for first-time home buyers, basically for younger people. We do not think it will have any serious impact on the actuarial basis of the program.

Senator Tower. I've had a considerable manifestation of interest from authorities in my State over the recommendation of the New Federalism proposal that you were told to develop block grants into the revenue-sharing program over a transition period.

Has the Department made some estimate of the effect of the New Federalism proposal on the ability of cities to meet their special community development needs and their ability to serve low-income areas?

Secretary Pierce. We think they would have basically the same income from the Government as they have now. They would have more flexibility as far as what they wanted to do with the money.

And so, they would have greater freedom in using the money, and they'd have the same amount. I don't see how it would harm them very much.

Senator Tower. In other words, the decisionmaking process would, in fact, involve the local community with no penalty in terms of the amounts available to them?

Secretary Pierce. Yes, that's right.

Senator Tower. Mr. Secretary, I have some additional questions and I would appreciate it if you would respond to for the record in writing.

[Response to written questions of Senators Tower, Heinz, and Sasser follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATORS TOWER AND HEINZ

Q. Mr. Secretary, do you expect that delegated processing will have the effect of crowding out private mortgage insurance?

A. HUD is not seeking expansion of its programs through the use of direct endorsement, nor do we expect this new procedure to increase the FHA market share.

The Department is looking for better ways of serving the "FHA market", i.e. primarily first-time and low- to moderate-income urban homebuyers. Direct endorsement, which is scheduled to begin early in May, is one way of improving FHA's program efficiency, and is part of the Administration's broad effort to transfer governmental functions to the private sector wherever appropriate and feasible.

Q. Has the Department projected any change in the credit budget needs of FHA and GNMA due to delegated processing?

A. No, it has not. We do not expect direct endorsement to increase our credit needs. In fact, the Direct Endorsement program may have the effect of reducing our credit needs since we now count conditional commitments which do not reach endorsement against the credit ceiling. Under the new program, the Department will count only those loans that reach endorsement.

Q. Mr. Secretary, the committee has received a proposal from the private mortgage insurers for a shared risk program, which is seen as a way of dealing with the FHA backlog of mortgage insurance applications. I would like to have your written comments for the record on this proposal.

A. The shared risk insurance program which has been proposed by MICA is much more than an offer to help HUD keep up in processing the flood of mortgage insurance applications which has resulted from the drop in interest rates. We believe that this proposal, under which the Department would enter into reinsurance agreements with Mortgage Insurance Companies (MICs), is seriously flawed, for the following reasons:

- The proposal would extend both FHA insurance and GNMA guarantees to all mortgages underwritten in MICs, thereby expanding MIC business significantly, and greatly increasing Federal involvement in both mortgage finance and insurance, a position counter to the current Administration policy of limiting Federal intervention in credit markets.

- It is not true that FHA insurance premiums would be lower under this program. Under the shared risk proposal, MICs would be in a position to reinsure only those loans with downpayments of five percent or more which they accept as credit risks, leaving FHA with 100 percent coverage of the riskier loans. Given higher risk FHA-insured loans under the proposed program, either artificially low premiums would be charged, with unmet costs to the insurance fund being picked up by taxpayers, or a prohibitively high premium, harmful to FHA buyers, would be calculated on the basis of actuarial soundness.

- Last, if MIC's were to handle all servicing and claims, as proposed, they would not be obligated under Congressional mandates regarding forbearance and mortgage assignment protection for mortgagors in financial difficulties, as is FHA.

For these reasons, we would not support the proposed shared risk program.

QUESTIONS OF SENATOR SASSER AND RESPONSES FROM SECRETARY PIERCE

SENATOR SASSER

For Secretary Pierce:

Mr. Secretary, as you know, last night the Appropriations Committee of the Senate, of which I am a member, reported an emergency supplemental appropriations bill to the full Senate -- the jobs bill. It includes a provision relating to the Urban Development Action Grant -- or UDAG -- program, calling for the expenditure of the $244 million that your department had requested be deferred.

Since the reason the House and Senate have both acted to preserve these UDAG funds is that UDAG has been one of the most productive and cost-efficient programs around in recent years, the idea is to get the money out into the field, into productive use in cities and towns across the country to create jobs and a more stable economic base.

I am very much concerned by reports that two-thirds of the unused UDAG funds from prior years has come from the small cities set-asides. I want to make absolutely certain that HUD is going to take an active role in seeing that the funds we provide do not lie fallow at the Department while small towns and cities continue to deteriorate and jobs continue to disappear.

How important do you believe technical assistance will be in promoting full use of the UDAG program by small cities, and what plans do you have for providing such assistance?

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Planning and Development

Urban Development Action Grants

Question: What is HUD doing to assist small cities to participate in the UDAG program?

Answer: In addition to the proposed legislative change that would shift center cities of less than 50,000 population into the Small Cities category for UDAG funding purposes, several technical assistance and outreach efforts are underway.

"Technical Assistance and Outreach."

The UDAG Office has under contract three national technical assistance providers who have work programs aimed at assisting small cities package UDAGs.

(1) National Development Council (NDC) - NDC administers for the Department the Small Business Economic Revitalization (SBR) program. One of the things they do under this program is to train local economic development professionals in 20 states nationwide to be able to identify and package UDAG projects; especially small city projects.

(2) Halcyon - Halcyon Ltd., a development firm is the UDAG master contractor. The objective of the contract is through the use of a multi-disciplined team of qualified experts to assist distressed cities plan and package fundable UDAG projects and, to work with cities who have received preliminary approval of a grant and then have difficulty bringing the project to implementation or completion. Because small cities have a much more difficult time in all phases of the UDAG program, a large percentage of Halcyon's time is spent on assisting small cities.

(3) National Association of State Development Agencies (NASDA) - The purpose of this contract is to assist five states to improve their ability to help local governments use CDBG and UDAG funds for economic development in ways that maximize the complimentary use of the private sector and other state resources. As part of this effort, the contractor will provide technical assistance to five states using peer-to-peer counseling to increase the states' capacity to support local economic development in small cities.

In addition to those three contracts UDAG has encouraged and participated in state sponsored conferences on what UDAG is, and how to participate in the program. At a minimum, the States of Arkansas, Maryland, Missouri, Kansas, Massachusetts, Ohio, Florida, Georgia, New York, Delaware, Pennsylvania and Oregon have all held such conferences.

Finally, there was a recent mailout campaign by the Area Offices whereby all 10,000 eligible small cities were sent a specifically designed UDAG small cities pamphlet describing the program and identifying an Area Office contact person to answer any questions regarding the program. We are currently doing a follow-up to this effort to evaluate how successful it was in getting the word out to small cities on the availability of the UDAG program.

Senator Sasser's questions concerning the Department's Field Reorganization Plans for the State of Tennessee were twofold: (1) Has HUD carefully reviewed the findings of the GAO study in terms of its plans to consolidate the multifamily functions into one office; and (2) will HUD reconsider its plans to proceed with its consolidation plans.

The Department originally decided to proceed with its plan to consolidate the multifamily functions in the State of Tennessee into the Knoxville Area Office based on the following reasons:

-- The current organizational structure impedes efficient and effective program delivery;

-- The current organizational structure is managerially and organizationally inefficient;

-- Cost savings are significant; and

-- Declining multifamily workload in the State of Tennessee.

After carefully reviewing the recommendations of the GAO study, we determined the GAO study results had not taken into consideration the continuing record of organizational deficiencies clearly documented in all management assessments since 1978. We found this to be an important shortcoming in the GAO assessment; particularly with regard to the longitudinal nature of the problems viewed by HUD management.

Further, from the Department's perspective, there are a number of areas where we must take strong exception to the assumptions and methodology used by the GAO in its attempt to collect and analyze cost-benefit data on the proposed consolidation planned for Tennessee. Frankly, after reviewing the workload of the two multifamily locations currently in operation in the State, we determined that there continues to be no justification for both offices to handle the function at a less than adequate workload level.

In a separate letter to Senator Sasser, I reviewed these considerations at length, and we are providing copies of these documents and analyses for the record. (See Attachments A, B and C). We have carefully considered the anaysis and recommendations provided by the GAO study; however, we feel that there is a clear need and justification for the Department to proceed in Tennessee with the multifamily consolidation as originally planned.

SENATOR SASSER

For Secretary Pierce:

Last August, a HUD interdepartmental memorandum outlined a proposed reorganization of HUD field offices nationwide. One of the stated purposes of the reorganization was to eliminate dual-track housing operations (where single-family and multi-family housing operations are organizationally separated).

On August 31, HUD submitted the cost-benefit analysis I had requested and cited the primary reason for the proposed transfer as being "the inefficient and ineffective program delivery and client service that has been characteristic of the current office configuration in Tennessee." The analysis also specified certain cost savings from the proposed move that at the time seemed unjustified.

On February 25 of this year, the GAO released its final report on the proposed relocation. The report concluded: (1) that the major justification for the reorganization could not be substantiated; (2) that "HUD's cost analysis contained assumptions and estimates that were neither adequately supported not based on sound planning or detailed study"; and that HUD did not consider the impact of changing initiatives in its proposal to reorganize in Tennessee.

Mr. Secretary, I hope you have read the GAO report. It recommends that you reevaluate the proposal and in the reevaluation consider the following: (1) that you justify that the reorganization is necessary and desirable and demonstrate how it will improve program delivery and client service; (2) develop a complete and detailed cost/benefit analysis based on sound planning, and (3) consider the effects of new initiatives in making your final decision regarding the most appropriate organizational structure in Tennessee.

I hope you will heed these recommendations; and in that light, I would like to ask if you will consider rescinding the regulations calling for reorganization? NO 6 ①

Further, the GAO report not only thoroughly discredits the way in which HUD calculated its anticipated savings and costs, but more importantly finds absolutely no justification for changing the organization structure. If you were the president of a corporation and you requested an independent audit of a proposed reorganization of the company, and that audit showed essentially that the costs outweighed the benefits, would you ignore that analysis? ②

Mr. Chairman, I would like to request that the GAO report discussed this morning be included in the record.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

February 25, 1983

B-209537

The Honorable Jim Sasser
United States Senate

Dear Senator Sasser:

Subject: Impact of the Department of Housing and Urban Development's Proposed Consolidation Plan on Tennessee (GAO/RCED-83-100)

Your September 14, 1982, letter requested that we evaluate the Department of Housing and Urban Development's (HUD's) proposal to move its Nashville multifamily housing function to Knoxville, Tennessee. That proposal is part of a major reorganization of field activities now under consideration by HUD.

Justification for the proposed relocation, furnished to you by HUD, cited inefficient and ineffective program delivery and client service as the primary reason for consolidating multifamily housing. HUD contends that the only viable option to correct program delivery and client service problems is to reorganize. In support of its reorganization proposal, HUD provided you a cost analysis showing a net savings of $276,030 at the end of 2 years and $1,282,575 at the end of 5 years if multifamily functions were consolidated in Knoxville, HUD's preferred option. If the Knoxville office functions were moved to Nashville, HUD estimates that there would be no net savings at the end of 2 years, but instead, net costs of $582,524. HUD did not complete the cost analysis for moving to Nashville and did not estimate net results at the end of 5 years for that option.

To evaluate HUD's proposal, we examined pertinent documents and interviewed officials of HUD, other federal agencies, and state agencies. In addition, we administered a questionnaire to obtain an indication of Nashville and Knoxville HUD staff's willingness to relocate and related costs. As agreed with your office, we concentrated our efforts on assessing costs and benefits of HUD's Option I.

Based on our evaluation, we do not see support that past program delivery and client service problems were the result of the organizational structure in Tennessee. Further, we found no evidence that serious program delivery or client service problems currently exist.

HUD's cost analysis contained assumptions and estimates that were neither adequately supported nor based on sound planning or detailed study. Overall, we believe that HUD's analysis understates the cost of consolidation and overstates the potential savings.

Finally, we found no evidence that HUD considered the impact of changing initiatives in its proposal to reorganize in Tennessee. HUD's programs and direction are changing, and some of those changes will affect the organization and staffing levels of its field multifamily housing operations.

Based on our findings, we recommend that the Secretary of HUD reevaluate the proposal to consolidate Tennessee multifamily housing in light of the information in this report. In this reevaluation the Secretary should (1) justify that the reorganization is necessary and desirable and demonstrate how it will improve program delivery and client service, (2) develop a complete and detailed cost/benefit analysis, and (3) consider the effects of new initiatives in making his final decision regarding the most appropriate organizational structure in Tennessee.

The results of our review are discussed in more detail in Enclosures I and II. We did not obtain agency comments. As arranged with your office, unless you publicly announce its contents earlier we will not distribute this report until 10 days after its issue date. At that time, we will send copies to other interested parties upon request.

Sincerely yours,

for J. Dexter Peach
Director

Enclosures - 2

(380588)

BACKGROUND

Responsibility for the Department of Housing and Urban Development's (HUD's) multifamily housing programs in Tennessee is divided between the Nashville Multifamily Service Office and the Knoxville Area Office. HUD's Nashville office serves roughly two-thirds of the State, geographically, about 60 percent of Tennessee's population and nearly 62 percent of HUD multifamily projects. The Knoxville office serves the remaining one-third of the State, about 40 percent of the population and 38 percent of HUD multifamily projects.

In early 1982, the Regional Administrator in Atlanta proposed consolidating the Nashville and Knoxville multifamily personnel and functions at Knoxville; staff to serve single-family housing programs were to remain in Nashville. That proposal was subsequently incorporated as a part of an overall proposal to reorganize HUD's field office operations under consideration by HUD at the time of our review.

HUD's proposal for consolidating multifamily housing activities in the Knoxville Area Office is based on its conclusion that inefficient and ineffective program delivery and client service are inherent in splitting the responsibilities for multifamily housing between two locations in Tennessee. As support for that position, HUD cites regional Management Performance Reviews of its Tennessee offices conducted in 1979, 1980, and 1982. (No Management Performance Review was performed in 1981.) HUD's accompanying cost analysis, prepared in August 1982, addressed two options. Option I would consolidate multifamily housing functions in Knoxville and Option II would relocate the Knoxville Area Office to Nashville. For Option I, HUD's preferred option, HUD estimated net savings of $276,030 at the end of 2 years, and $1,282,575 at the end of 5 years. If the Knoxville office functions were moved to Nashville, Option II, HUD estimated that there would be no net savings at the end of 2 years, but instead, net costs of $582,524. HUD did not complete the cost analysis for Option II and did not estimate net results at the end of 5 years.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate HUD's proposal to move its Nashville multifamily housing function to Knoxville. To evaluate HUD's justification and rationale for the reorganization, we examined management reviews of HUD's Tennessee housing activities conducted between 1979 and 1982 and other pertinent documents and correspondence relating to management performance and organizational issues. We interviewed officials and examined documents and correspondence at HUD's Washington, D.C. Central Office, Atlanta Regional Office, Knoxville Area Office, and Nashville Multifamily Service Office. We discussed the quality of HUD's client service, program delivery and other implications of the current organizational structure and proposed reorganization with Tennessee housing industry representatives and the Tennessee

Housing Development Agency. In addition, we interviewed HUD officials in Ohio and Michigan, states where HUD also delivers multifamily programs through area offices and service offices.

To evaluate HUD's cost analysis, we interviewed the Atlanta Regional Office personnel responsible for developing the assumptions and data used to prepare the analysis. We analyzed the data and assumptions and discussed them with Knoxville Area Office and Nashville Service Office managers and supervisors. We examined documents and reports relating to staffing and workload and management of multifamily housing in Tennessee and Federal regulations relating to employee relocation. We interviewed General Services Administration Region IV Real Estate Division personnel regarding HUD's Tennessee office space lease costs and terms and a representative of the Tennessee Department of Employment Security regarding unemployment compensation.

On Friday, December 3, 1982, we administered a questionnaire to obtain an indication of Nashville and Knoxville staff's willingness to relocate and associated costs. (Responses are summarized in Enclosure II.) Of 191 Nashville and Knoxville staff on board, 160 people (or 84 percent) completed the questionnaire.

HUD did not seriously consider nor complete its cost analysis for Option II, relocating the Knoxville Area Office to Nashville. Therefore, as agreed with our requestor's office, we concentrated our efforts on assessing HUD's costs and savings estimates for its preferred option, consolidating multifamily functions in Knoxville.

In our analysis, where possible, we attempted to refine and update the data and assumptions HUD used. The results of our analysis, nevertheless, do not represent precise or definitive data.

We performed our review in accordance with generally accepted government audit standards.

MANAGEMENT REVIEWS DO NOT SUPPORT CONSOLIDATION

We reviewed the Management Performance Reviews cited by HUD plus a recent memorandum from the Atlanta Regional Administrator. All of these documents assert that HUD's Tennessee offices have had a continuing record of organizational deficiencies since 1978. However, we found that the problems described in those reports were attributed largely to personnel matters--either position vacancies or ineffective employees occupying critical positions. The 1979 report states:

> "The current organization of the State of Tennessee Area Office and Service Offices is seriously hampering effective management and supervision of the Housing Division personnel in all three offices."

However, both the 1980 and 1982 reports cite improvements in multifamily housing operations in Tennessee and attribute them to the resolution of personnel matters--either by filling vacant positions with qualified employees or by restaffing positions occupied by ineffective employees.

--The 1980 report notes substantial improvement in overall management, communication, and monitoring by Knoxville but lists continuing problems restricting effective management and supervision of Housing Division staff in Tennessee. Again, the report points to vacancies or ineffective incumbents in key positions as causes of the problems. The report emphasized the lack of strong, well qualified supervision in the Nashville office.

--The 1982 report cites improvement in the overall management of the Nashville Service Office. The report lists supervision of six Knoxville Administration Division personnel outstationed at Nashville and Memphis as a problem. The report emphasized the 14-month time lapse since Knoxville Administration Division staff had visited either Service Office.

HUD's Central Office also conducts reviews of field offices. A February 1982 report on Nashville's multifamily operations cited that clients had experienced a good to excellent relationship with that office. The report concluded that, overall, industry was very positive regarding office processing and management.

Developers and finance officers reported no current problems in their interactions with HUD Tennessee offices. Some mentioned that Nashville's operations had been less effective in the past but had since improved. An official of the Tennessee Housing Development Agency made similar observations and attributed the improved service to staffing changes in recent years. An Atlanta-based multifamily developer who operates in several States ranked the Nashville and Knoxville HUD offices in the upper quartile of all HUD offices with which he interacts. We spoke with Area Office Managers and Multifamily Service Office Supervisors in Michigan and Ohio. In those States, as in Tennessee, multifamily operations are split between the area office and service offices. Those HUD officials cited no program delivery problems resulting from their organizational structure but acknowledged that the potential for policy fragmentation exists. However, they added that effective communications precluded such a problem. HUD's overall field reorganization proposal does not include consolidating multifamily housing functions in Ohio or Michigan.

COST/SAVINGS OF CONSOLIDATION

HUD estimated that a $395,000 one-time cost to implement the consolidation proposal at Knoxville and a $33,000 recurring annual increase in travel costs would be offset by recurring annual personnel and office space savings and result in a net savings at the end of 2 years of $276,030 and a $1,282,575 savings at the end of 5 years. Our detailed analysis of the underlying support for HUD's costs and savings estimates showed that HUD did not include certain costs and that other costs were either over or understated because HUD used faulty assumptions. Overall our analysis raises basic questions about the reliability of HUD's estimates as support for the proposed consolidation. For example, HUD did not include cost estimates for employees that may elect early retirement or for potential reimbursements to the State of Tennessee for unemployment compensation payments. Further, HUD underestimated employee relocation costs, in part, because their analysis was prepared prior to changes in Federal Travel Regulations that greatly increase benefits for transferred Federal employees.

HUD's cost savings estimates were similarly misstated. For example, HUD overestimated personnel savings because it overstated the number of positions that would be eliminated by the consolidation. Also, HUD understated office space savings because it used invalid assumptions and inaccurate cost data.

Basis for Cost Estimates

When HUD prepared its August 1982 cost analysis of the reorganization in Tennessee, it had not developed detailed plans for the proposed consolidation. Because of that, there are many uncertainties regarding the proposed staffing of HUD's Tennessee multifamily functions. For example, in its cost analysis, HUD states that 42 of the 67 Nashville employees on board as of August 1982 would be offered transfers to Knoxville. The Atlanta Regional Office Director of Housing told us that the number that would be offered transfers was hypothetical.

HUD's analysis also states that a staff of 23 would remain in Nashville to perform single-family housing functions although workload data provided us in support of the consolidation proposal showed a Nashville single-family staff of only 15. The Atlanta Regional Office Director of Housing told us that the staffing used in HUD's cost analysis was judgmental.

In addition, HUD's analysis assumes that 50 percent, or 21, of the 42 Nashville employees offered a transfer to Knoxville would accept. The Atlanta Regional Office representative who prepared HUD's cost analysis told us that, based on past experience, HUD's Central Office estimates that up to 60 percent would accept offers to relocate. However, the cost analysis figure was adjusted downward to reflect Tennessee's more favorable economic conditions. That official told us the downward adjustment was judgmental.

Finally, HUD's cost analysis assumes that the remaining 23 Nashville employees (67 on board minus 23 remaining as single-family minus 21 accepting transfers to Knoxville) would be terminated.

In our analysis, where possible, we attempted to update and refine HUD's staffing assumptions. For example, we used the number of HUD employees located in Nashville as of early December 1982, or 61 employees. We used HUD's single-family staffing level of 23 at Nashville leaving 38 employees to be offered positions in Knoxville. We assumed that our questionnaire results were more precise than HUD's estimate and therefore used those results, which showed 71 percent, or 27 Nashville employees, would definitely or probably accept a transfer to Knoxville. We assumed that the remaining 11 employees would terminate employment with HUD.

Early Retirement

The civil service retirement system incurs additional costs when employees retire early. The Office of Personnel Management has determined that each early retirement creates a liability of 130 percent of the employee's final salary. The additional cost to the retirement system results primarily because early retirees receive immediate benefits, with little or no reduction.

Employees are eligible for early retirement if their positions are abolished or transferred to a location outside their commuting area. To retire under early retirement provisions, an employee must (1) be at least age 50 with 20 years of service or (2) have 25 years of service.

We recognize that the likelihood of employees electing early retirement is highly uncertain; however, the cost of early retirement can be substantial and should be acknowledged. Three Nashville employees would be eligible for early retirement in January 1983. If those three employees elected early retirement because of the reorganization, costs to the retirement system would be about $106,000 based on their current salaries. HUD did not include the cost of early retirement in its analysis.

Unemployment Compensation

Federal employees are entitled to unemployment compensation benefits in accordance with the standards of the State in which they reside. The U.S. Department of Labor uses appropriated funds transferred to it by the employing Federal agency to reimburse the States for unemployment compensation paid to former Federal employees.

In Tennessee, a former Federal employee who was earning $27,640 per year (the average salary of HUD Nashville staff) at the time of separation would be eligible to receive $110 for 26 weeks and those benefits currently can be extended for up to 13 weeks. Further, if the results of our questionnaire are correct, 11 Nashville employees would not accept a transfer and would terminate employment with HUD. Excluding the three employees who would be eligible for early retirement, eight would be entitled to unemployment compensation.

While there are many uncertainties regarding who would terminate and whether they would require unemployment benefits or for how long, to recognize the potential cost of unemployment compensation, we used data from a July 1981 Congressional Budget Office study entitled "Cost of Potential Layoffs Under the Administration's Federal Employment Reduction Program." That study acknowledged that any estimate of layoff costs is highly uncertain since actual data was not available on the salaries, ages, and years of service of laid-off employees. The same reservations apply to our cost estimates.

The Congressional Budget Office assumed that 92 percent of the employees involved in a reduction-in-force would receive average weekly unemployment benefits of $102 for 15.9 weeks. Using those assumptions for the eight employees described above, we estimate that unemployment compensation would amount to about $12,000.

Severance Costs

Federal employees involuntarily separated from Government service are entitled to severance pay and a lump-sum payment for their unused annual leave. Both entitlements are based on the employee's salary at time of separation. The amount of severance pay is additionally based on years of service, and the payment increases for each year the employee is over age 40. The amount of the lump sum annual leave payment is also based on the number of days of unused leave accumulated.

In its computation of severance costs, HUD used national averages of field employees' salaries and years of service to estimate the average per-employee severance pay--$8,590. To estimate lump-sum annual leave payments, HUD used the HUD-wide average--$1,500 per employee. HUD estimated that severance pay and lump-sum leave payments for the 23 Nashville employees it believes would be unwilling to transfer to Knoxville would amount to $232,070.

We found that Nashville employees' average salary, years of service, and unused annual leave differed from the amounts HUD used. Since local averages would be more representative, we used the Nashville averages and computed a higher per-employee severance payment--$10,865--and lump-sum leave payment--$2,126. For the 11 current employees whom our questionnaire shows would not be willing to transfer to Knoxville less the three who would be eligible for early retirement, severance costs would be $103,928.

Relocation Costs

Federal travel regulations authorize reimbursement for certain relocation costs when employees are required by their job to permanently transfer from one location to another. In addition to residence transactions and transportation of households goods, other costs, such as travel with dependents to locate a new residence and occupancy of temporary housing, are also reimbursable.

The largest reimbursable expense involves residence transactions for employees who buy or sell their homes. Effective October 1, 1982, Federal Travel Regulations (General Services Administration Bulletin FPMR A-40, General Supplement 4) entitle relocated employees to receive up to $15,000 in connection with the sale of a residence at the old official station and up to $5,000 toward purchasing a home at the new official station. The regulations in effect when HUD developed its cost analysis entitled relocated employees to receive significantly less.

HUD estimated that relocation costs would amount to $14,000 for each transferred employee. For the 21 Nashville employees the agency estimated would accept offers of relocation to Knoxville, HUD computed a total employee relocation cost of $294,000.

HUD's $14,000 per employee estimate of relocation costs was based on a model move of a family of four relocating 500 miles. We used HUD's model, but reconstructed the cost for an actual move from Nashville to Knoxville--about 180 miles. Also, we used the results of our employee questionnaire to establish the number of Nashville employees willing to relocate and the number and kind of residence transactions that might be expected. For instance, 33 percent of the Nashville employees willing to relocate owned residences which they would definitely or probably sell if offered a transfer and would also purchase a new residence in Knoxville within 1 year. Another 33 percent either would sell their residences in Nashville or would purchase a residence in Knoxville. For those willing to relocate residence costs alone could reach $263,000. We estimated total relocation costs at about $440,000.

Adjustment to Costs

HUD offset one-time reorganization costs by a $131,070 savings it called "avoided cost." HUD claims that this represents costs that would have been incurred if it had to separate 13 excess Knoxville housing employees. Under the reorganization, these 13 employees would be shifted to positions vacated by Nashville employees unwilling to relocate.

We found no basis to accept HUD's premise that the excess employees would be terminated without the consolidation or that they could be shifted to and retrained for other available positions. In this regard, the Knoxville Area Office has had excess employees in its Housing Division since at least 1980.

Travel Costs

HUD estimated that recurring annual increase in travel costs because of the consolidation in Knoxville would be 50 percent of Nashville's prior year travel expenditures or $33,000. The Atlanta Regional Office representative who prepared HUD's cost analysis told us the method used to estimate the increase was based on consensus of opinion of other regional officials involved in the cost analysis.

Our estimate of the annual increase in travel costs used the multifamily project workload currently served by Nashville-based staff and the requirements for project monitoring visits set out in HUD handbooks and policy guidance. We computed the increase in mileage required to serve that workload if multifamily functions were consolidated in Knoxville. Except for trips to Nashville and Memphis, we used an average of three project visits during any one trip. Considering the concentration of workload in Nashville and Memphis, we used six project visits per trip to those locations. We established the average number of project visits per trip by consulting with the Director of Housing in Knoxville and the Multifamily Service Office Supervisor in Nashville. Although the number of project inspection or monitoring visits achievable during any one trip is influenced by a variety of factors, based on our discussions with those Tennessee HUD officials, we believe our figures are reasonable.

We did not attempt to estimate increases in food and lodging costs for site visits in Nashville and other areas which, at present, involve only local travel or travel of shorter duration. Nevertheless, using the method described above, we estimate that the annual increase in transportation costs alone could exceed $72,000. It should also be noted that the annual increase in employee travel time to visit Central and Western Tennessee project sites from Knoxville instead of Nashville could be substantial. If our project visit assumptions used above are correct, the annual increase in employee productivity lost to travel could reach 6,700 hours.

Personnel Savings

The largest single cost savings from HUD's proposal for consolidation relates to eliminating nine positions--an annual savings of $341,528. HUD claims that duplications in four management or supervisory positions would be eliminated and that five other positions would be eliminated because of economies of scale. HUD provided us a list of the nine positions they estimate would be eliminated and information showing proposed organizational structure and staffing after the proposed consolidation.

HUD's computation of savings includes the elimination of a Chief of Loan Management and Property Disposition. Under HUD's consolidation proposal, a Loan Management and Property Disposition Branch will continue to operate at both locations and two branch chiefs will still be required. HUD's proposal would cut the size of that branch's Nashville staff; but the position of Chief would be downgraded, not eliminated. In addition, in view of the substantial loss of productivity resulting from the increased travel time from Knoxville to monitor HUD's multifamily projects in Central and Western Tennessee, we question some of the personnel savings HUD claims will result through economies of scale. Unless the level of multifamily project monitoring activity is reduced, the time lost to travel must be offset by either increased overtime payments or increased staffing. Three of the five positions which HUD claims will be eliminated through economies of scale are directly involved in project monitoring. If the salaries for the staff involved in project monitoring were excluded from the estimate and the Branch Chief position described above was adjusted using December 1982 salary figures, personnel savings would be $197,109.

Space Savings

HUD estimated that office space costs of $26,987 would be saved annually if multifamily functions were consolidated in Knoxville. The savings were computed in two steps. HUD first estimated that a savings of $15,965 would result from reducing office space required to house the nine positions they claim would be eliminated by the consolidation. Second, locating 42 Nashville positions in Knoxville would reduce office space needs at Nashville, so HUD assumed that Knoxville would have to increase its office space by that same amount. It also assumed that, since the rental rates it pays the General Services Administration (GSA) are less in Knoxville than in Nashville, an additional savings of $11,022 would accrue from locating the 42 positions in Knoxville.

We found, however, that the Government's cost for HUD's office space--the amount GSA pays private lessors--is higher in Knoxville and lower in Nashville than the figures HUD used in its computation. Those differences result from GSA's method for establishing its so-called Standard Level User Charge or rental rate. We also found that both the Knoxville and Nashville offices occupy space in excess of their current needs, and that Knoxville could accomodate the proposed consolidation without acquiring more space.

Therefore, we estimated the savings of office space cost directly attributable to consolidation at Knoxville by first establishing Nashville's office space needs without consolidation. From that, we deducted the costs of space to house the 23 employees HUD estimates will remain at Nashville after consolidation. The resulting space cost savings amounts to nearly $82,000.

IMPACT OF CHANGING INITIATIVES

HUD's programs and direction are changing, and the future organizational structure and size of its field operations is uncertain. Current proposals shift responsibility from the Federal Government to the private sector and local government. For multifamily programs, HUD has undertaken contracts with private vendors to perform a number of tasks. HUD now expects that its entire multifamily HUD-held inventory will be under servicing and debt collection contracts by the end of 1984. Further, arrangements for contract or fee appraisals and inspections of multifamily projects are being tested and are expected to increase. We believe the potential for such changes in HUD's program delivery raises basic questions as to the need for relocating HUD field employees in the face of uncertainty. In this regard, we found no evidence that HUD considered the impact of changing initiatives in its proposal to reorganize in Tennessee.

CONCLUSIONS

HUD contends that inefficient and ineffective program delivery and client service are inherent in splitting the responsibilities for multifamily housing between its offices in Knoxville and Nashville, Tennessee. Further, HUD asserts that the only viable option to correct program delivery and client service problems is to reorganize. Based on our evaluation, we do not see support that past reports of program delivery or client service problems were the result of the organizational structure in Tennessee. Further, we found no evidence that serious program delivery or client service problems currently exist.

In support of its reorganization proposal, HUD developed a cost analysis showing a savings if multifamily housing functions were consolidated in Knoxville as proposed. However, we found that HUD's cost analysis contained assumptions and estimates that were neither adequately supported nor based on sound planning or detailed study. Further, HUD's analysis understates the cost of consolidation and overstates the potential savings.

Finally, we found no evidence that HUD considered the impact of changing initiatives in its proposal to reorganize in Tennessee. HUD's programs and direction are changing, and some of those changes will affect the organization and staffing levels of its field multifamily housing operations.

RECOMMENDATIONS

We recommend that the Secretary of HUD reevaluate the proposal to consolidate Tennessee multifamily housing operations in light of the information in this report. In this reevaluation the Secretary should (1) justify that the reorganization is necessary and desirable and demonstrate how it will improve program delivery and client service, (2) develop a complete and detailed cost/benefit analysis based on sound plans, and (3) consider the effects of new initiatives in making his final decision regarding the most appropriate organizational structure in Tennessee.

SURVEY ON WILLINGNESS TO RELOCATE

HUD is currently considering a field reorganization which impacts upon their employees in the State of Tennessee. Some alternatives being considered involve relocation of HUD personnel. The General Accounting Office is studying the costs and benefits being considered by HUD in its reorganization plans. As a part of the study, we need an indication of your willingness to relocate. We do not need your name, and your responses will be anonymous. Therefore, we would appreciate your honest responses to the following questions.

1. What is your current grade?

	Nashville (56 respondents)		Knoxville (104 respondents)	
	Number	Percent	Number	Percent
GS-6 or under	19	(34)	35	(34)
GS-7 through 10	3	(5)	11	(11)
GS-11 or 12	28	(50)	43	(41)
GS-13 or higher, including SES grades	6	(11)	15	(14)

2. What is your present position? (Optional)

Nashville (number)	Knoxville (number)
42 [1]	52 [1]

3. If your job were transferred to Knoxville (Nashville), would you move?

		Nashville (56 respondents)		Knoxville (104 respondents)	
		Number	Percent	Number	Percent
Definitely yes	Continue	30	(53)	67	(65)
Probably yes		10	(18)	24	(23)
Uncertain		7	(13)	5	(5)
Probably no	Return Survey	2	(4)	1	(-)
Definitely no		7	(13)	7	(7)

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[1] The data collected for this question were inconclusive and were too extensive to summarize herein.

4. Assuming you did move to the Knoxville (Nashville) area, what would you most likely do about housing there?

	Nashville (47 respondents)		Knoxville (96 respondents)	
	Number	Percent	Number	Percent
Live with family or friends rent-free	1	(2)	-	(-)
Rent temporarily but would purchase within one year	18	(39)	35	(36)
Rent with no intention to purchase within one year	13	(28)	17	(18)
Purchase right away	6	(13)	32	(33)
Commute from current residence	1	(2)	-	(-)
Uncertain	8	(17)	12	(13)

5. What is your present housing arrangement?

		Nashville (47 respondents)		Knoxville (96 respondents)	
		Number	Percent	Number	Percent
Live with family or friends rent-free	Return Survey	2	(4)	1	(1)
Rent	Continue	7	(15)	13	(14)
Own		38	(81)	82	(85)

6. Would you attempt to sell your current house if you moved to the Knoxville (Nashville) area?

	Nashville (38 respondents)		Knoxville (85 respondents)	
	Number	Percent	Number	Percent
Definitely yes	15	(39)	39	(46)
Probably yes	8	(21)	14	(16)
Uncertain	6	(16)	17	(20)
Probably no	5	(13)	10	(12)
Definitely no	4	(11)	5	(6)

THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

Honorable Jim Sasser
United States Senate
Washington, D. C. 20510

Dear Senator Sasser:

This is in response to your letter of February 25, 1983 which forwarded the General Accounting Office's final report concerning the proposed consolidation of multifamily functions in the State of Tennessee into the Knoxville Area Office.

The Department is considering this transfer of function for the following reasons:

-- The current organizational structure impedes efficient and effective program delivery;

-- The current organizational structure is managerially and organizationally inefficient;

-- Cost savings are significant; and

-- Declining multifamily workload in the State of Tennessee.

The GAO Report does not fairly or adequately address any of these points.

The GAO report asserts that the Management Performance Reviews of the Tennessee Offices ascribe program delivery problems to "personnel matters -- either position vacancies or ineffective employees occupying critical positions." Such an assertion does not agree with the quotes from 1979 and 1980 management reviews, as well as a 1982 memorandum from the current Regional Administrator. Attachment (A) provides copies of these documents.

In short, after the assertion that the basic problem is not organizational, the GAO Report ignores the continuing record of organizational deficiencies clearly documented in all assessments since 1978.

From the Department's perspective, there are a number of areas where we must take strong exception to the assumptions and methodology used by GAO. Attachment (B) provides a detailed discussion of these points. However, even if one accepts the GAO cost-benefit data as accurate, cost savings would be realized in three years if the Department's proposal were implemented. Furthermore, as the Department's cost-benefit analysis points out in its opening paragraph, "Even if no cost savings could be realized, the improved program delivery (i.e., correction of the problems described above) would fully justify the proposal to consolidate multifamily operations."

Attachment (C) demonstrates that based upon workload considerations, there is no apparent need for two multifamily office locations in the State of Tennessee. For example, the assisted housing development activity in Tennessee has declined 82 percent in the period 1978-1982. It should also be noted that other states in Region IV, with larger workloads and larger geographic areas, are serviced by one office location.

In summary, the GAO report presents no tangible basis for concluding that the Department needs to reconsider the proposed consolidation of multifamily operations in the State of Tennessee. In fact, by calling into question the original assumptions for the consolidation issue, the further analysis of the organizational change only serves to highlight the fact that this change is necessary to bring into better balance the application of the Department's limited resources.

Very sincerely yours,

Samuel R. Pierce, Jr.

Attachments

ATTACHMENT (A)

Management Review - April 1979

"The current three-tiered organizational structure of the HUD Tennessee Offices, Knoxville, Nashville, and Memphis is contributing substantially to problems in management of the Housing programs. Although a strong Director of Housing will provide much of the guidance and management now lacking and needed for the effective operation of the offices, it is unlikely that all the organizational problems will be thereby solved..."The current organization of the State of Tennessee Area Office and Service Offices is seriously hampering effective management and supervision of the Housing Division personnel in all three offices. The current authority structure requires the Nashville Service Office to be responsible for the Memphis Service Office, and the Knoxville Area Office to be responsible for the Nashville Service Office. This three-tiered authority structure has proven extremely difficult to implement, and the problems generated have proven to be substantial and of great concern. Upper level management staff in the Nashville and Memphis Service Offices have great concern about their authority and accountability..." (emphasis added).

Management Review - 1980

"As reported in our April 1979 report, the present organizational structure of the State of Tennessee Area Office and the Service Offices in Nashville and Memphis is continuing to restrict effective management and supervision of Housing Division staff in these offices. Although substantial progress has been made by the Knoxville Area Office Manager relative to Offices, the three-tiered authority structure is proving to be ineffective and cumbersome to manage. This is particularly evident with the split multifamily processing authority between the Nashville Service Office and Knoxville Area Office. Considering the present Departmental staffing policy, it is reasonable to assume that the Knoxville staff will continue to be involved with Nashville multifamily projects to the detriment of not expeditiously processing their own projects. To eliminate the present problem and provide expeditious service to our clients, the Department should consider (if it ever becomes possible) restricting all multifamily activity to the Knoxville Area Office which has the staff capability to insure rapid processing of all multifamily project applications received in Tennessee" (emphasis added).

The current Regional Administrator, Clifton G. Brown, stated in a September 23, 1982 memorandum:

> "It should be additionally noted that, prior to the 1982 review, we had proposed a shift of multifamily functions from the Nashville Office to the Knoxville Office, our July 1982 (management) report did not focus on the continuing operational problems that the "dual multifamily" office configuration is causing in our Housing programs. Nonetheless, it should be noted that the problems clearly articulated in the 1979 and 1980 reviews were present at the time of the latest performance review, and continue to hamper our operations in Tennessee to this very day" (emphasis added).

ATTACHMENT (B)

The following are specific concerns regarding the assumptions and methodology used by GAO.

1. Use of Questionnaire Results. As a basis for determining relocation costs and severance costs, the GAO surveyed employees in both Knoxville and Nashville to determine how many employees would accept a transfer to another location. The survey results indicated that a higher percentage of employees would accept a transfer from Nashville to Knoxville than the percentage estimated by the Department in compiling its relocation and severance costs. We believe the GAO figure is invalid for two reasons. First, while the entire populations of both offices were surveyed, 16% of the individuals surveyed did not respond. Since this is not a random sample, the results can be skewed and do not necessarily represent the actual views of the majority of employees. Second, employees tend to tell interviewers whatever will most likely impact negatively on the decision to proceed with the transfer of function. Therefore, we believe that our historical figures on the number of employees who have actually accepted transfers in past reorganizations have more predictive validity than figures which were derived from surveying the affected employees.

2. Early Retirement. The GAO report states that employees who retire early place an additional burden on the retirement system and that those figures should be included in the cost of the reorganization. We think that this is a highly speculative area and that the three employees the GAO noted as eligible for early retirement may or may not be affected by the reorganization and, if affected, may or may not retire.

3. Relocation Costs. Relocation costs, as estimated by the GAO, are significantly higher than those estimates by the Department. This results from the Department's estimate that 21 employees would relocate to Knoxville vs. the estimate of 27 by the GAO. In addition, the Department used its actual 1982 year-to-date cost figure of $14,000 per family move whereas GAO used their survey information and applied the maximum dollar entitlement under the new Federal Travel Regulations effective on October 1, 1982. Again, we believe that using the maximum dollar amount significantly overstates the probable costs of relocation and that using the survey results indicating the number of employees expected to move, to sell their existing homes, and to buy new ones inflates the cost.

4. Travel Costs. The GAO estimate of travel costs is too high. The GAO estimates that the increase in travel would be at least $72,000 or 218% greater than the Department's estimate. The $72,000 figure when added to the FY 1983 allocation of $164,500 for the entire State of Tennessee is significantly out of line with similar sized offices.

5. Personnel Savings. It is unclear how the GAO determined the number of personnel saved as a result of the reorganization. The Department stands by its estimate that 9 positions would be eliminated. Furthermore, the GAO claims that because of the increase in travel time, significant increases in staff would be required to compensate for increased travel. This is simply not true. Both the Birmingham Office, which covers the entire state of Alabama and is 25% larger geographically than Tennessee and the Denver HUD Office which covers the entire mountain states area or 920 X 900 miles receive the same allocation of multi-family staff per project as Tennessee.

Therefore, no increase in personnel will result from any increase in travel requirements.

6. Space Costs. The GAO analysis resulted in significantly higher space savings as a result of consolidation in Nashville than the Departmental estimates. The Office of Administrative Services in Headquarters reviewed the space situation and produced results similar to the Regional estimates.

ATTACHMENT (C)

The following workload data for the State of Tennessee clearly demonstrates that there is no apparent need for two multifamily office locations in Tennessee:

1. Assisted housing development activity in Tennessee has dropped 82 percent in the period 1978-1982.

2. In terms of comparison, other states in Region IV, with larger workloads and larger geographic areas, are serviced by one multifamily office location. For example, in FY 1979 both Florida (8,835 assisted housing reservations) and North Carolina (7,088 assisted housing reservations) had much larger workloads than Tennessee (5,540 assisted housing reservations), yet both states are at least 25 percent larger than Tennessee and effectively operated with only one multifamily office location.

3. While the unsubsidized insured housing workload is slowly beginning to recover in Tennessee, most of the activity is related to initiatives designed to generate low interest money (e.g., tandem targeted for UDAG, Section 103 bonds, etc.) and not overall demand at market rates. The unsubsidized insured housing workload in Tennessee in FY 82 was 997 starts and is projected to be approximately 1,875 for FY 83. By comparison, in FY 81 our Alabama office handled a higher unsubsidized insured workload (over 2,500 starts) from one office location in a state covering 25 percent more geography than Tennessee.

4. Even the housing management workload, while increasing moderately, does not require two office locations to service HUD's clients. In fact, most activities in housing management are performed via correspondence or on-site visits by HUD staff. When looking at total housing management activity (both multifamily assisted management and loan management), the workload for the Georgia office (1,213 total projects) is 32 percent higher than Tennessee (917 total projects). Georgia covers a geography 39 percent larger than Tennessee; yet one multifamily office location in Georgia effectively services this workload.

Senator Tower. Senator Dodd.

Senator Dodd. Thank you.

Mr. Secretary, I welcome you to the committee and appreciate your testimony.

In one part of your testimony, you talked about fair housing commitments, your commitments and the agency's commitment to it.

Certainly you are aware that a few years ago there was an effort in Congress to strengthen the Fair Housing Act of 1968 which was not successful upon analysis.

And I was sort of under the impression anyway that this administration was going to propose some amendments to expand compliance with our fair housing laws. Is this the case?

If so, when would you expect the administration to forward the Congress suggestions in these areas? And do you have any idea of what they would be?

Secretary Pierce. We do expect to amend the fair housing laws. They're being negotiated and worked on right now, between my Department and the Department of Justice.

When we have worked out our differences, the proposed bill will go to the Cabinet Council for legal policy at which time it will become finalized and it will be presented to the President. He, of course, will have the final say with respect to the bill.

It will, then, come to Congress.

The nature of the proposal that we're making is to increase the power of the Secretary of HUD in enforcement procedures. Right now we are limited basically to conciliation procedures. We want to make them stronger so that a Secretary can move into court quickly.

So, that's basically what we're trying to do.

That should be here, we hope, sometime in this early spring.

Senator Dodd. Sometime in early spring?

Secretary Pierce. Yes.

As I say, I can't guarantee exactly when it will come, because it has to go through quite a process.

Senator Dodd. I wonder if you've considered, in the area of housing discrimination, an area that doesn't oftentimes get discussed but, I gather, is one of some degree of seriousness, the question of discrimination against people with children in housing.

It's not uncommon to see advertisements for housing—oftentimes some landlords think of children as pets, I guess, and children are excluded—or families with children are excluded.

How serious of a problem is that?

Secretary Pierce. Frankly, I can't tell you off the top of my head. Actually, in working with fair housing, we didn't give that any consideration.

In our own housing, naturally, we do have children. We make provisions for children.

I know in the private sector, conventional housing, so to speak, there is a good deal of housing that prevents families with children from renting space.

Senator Dodd. Are you aware of any studies done at all to determine how widespread that form of discrimination is?

Secretary Pierce. No, I am not. I have not made any studies, and I do not believe there have been any studies that have been made in the Office of Policy Development and Research recently However, following is a list of studies made several years ago:

"Housing Our Families," PD&R, August 1980.

"Families and Housing Markets: Obstacles To Locating Suitable Housing," Urban Institute, September 1980.

"How Restorative Rental Practices Affect Children," Survey Research Center, University of Michigan, August 1980.

"Measuring Restorative Rental Practices Affecting Families With Children: A National Survey," Survey Research Center, University of Michigan, July 1980.

"Monitoring Local Ordinances on Anti-Children Rental Practices," Dora Ashford, James Lowery, Irene Wolt, February 1982.

"Discrimination Against Families With Children in Rental Housing," Frank Schnidman; Christopher M. Lorenzo and Debbie R. Malinsky, Center for Urban Policy Analysis, 1980.

"How Selected HUD Programs Serve Low- and Moderate-Income Families," Urban Institute, 1980.

Senator DODD. Are we under the 5-minute rule, Mr. Chairman?

Senator TOWER. I think we'll permit 10. We do have another panel to appear here.

Senator DODD. Fine.

I just have a couple more, and I'll try to get through them quickly.

Senator TOWER. Right.

Everybody will not use his full 10 minutes. [Laughter.]

Senator DODD. Mr. Secretary, I notice in the budget that you made some suggestions that there be a change in the so-called housing voucher proposal offered last year and will now allow for some increases in a substantive amount over the terms of the contract.

I wonder if you might enlighten us as to whether these necessary subsidiary increases will be reflected in the original contract commitments or will these increased costs result in a diminishing number of certificates over time?

How is that going to work?

Secretary PIERCE. Actually, it would be left to the public housing authorities to decide whether there should be increases in that particular area. It will not be a national program. It will be done on an individual PHA basis. They will use part of their budgeted housing certificates for this purpose.

So, technically speaking, it's very possible for the number of housing certificates to diminish. We will be watching the situation very closely. If we think we are running into a problem there, we will ask for more certificates from Congress.

So, it's something we'll have to watch and observe. It's very possible it won't be a problem at all, but it is possible.

I think we'll have to see it work.

ELDERLY HOUSING

Senator DODD. Let me mention one other thing. I don't want to get parochial. We had a case in Connecticut which has provoked a great deal of interest—in certain quarters anyway—where people qualified for elderly housing, the age of a person that could apply and be admitted to that housing was dropped from the traditional age of older Americans to age 50. I'm told that's allowable under the law.

Are there not some standards to be applied to the age of older Americans that are applied pretty directly across the board?

Secretary PIERCE. I think that's allowable under the law, too. But just to check it—I have my general counsel here, and I'll ask him.

Senator DODD. I'm speaking to specifically the Wind project in Waterbury, Conn.

Secretary PIERCE. I'm not familiar with that project.

We have Assistant Secretary Abrams here. He is familiar with the Wind Project. He can answer your question.

Senator DODD. Rentals are up to $1,000 a unit, and people qualify as older Americans at age 50. Waterbury Conn., is a nice town, but $1,000 a month is not the average rent.

Mr. ABRAMS. I think you have accurately portrayed what the situation is there. It's a good example of how the program built housing where it wasn't necessary at excessive costs.

In that particular situation, there is a surplus of elderly housing in that particular neighborhood where the housing project was developed. And there is not enough of an elderly waiting list who are willing to occupy the units in that particular neighborhood who are 62 years old or over.

So, the request came in to reduce the age of the eligible occupants of the building.

Our records show that over the years there will be enough of a demand in that community. But it is an anomaly of the Section 8 new, existing, and sub rehab program, that more units were built than the market needed, because there was no demand orientation to the program. It was strictly a program that thrived on the amount of subsidy and tax shelter that could be justified.

There was, of course, a subsequent project that was proposed in that community, which we concurred that it would be inappropriate to build more elderly housing in that community.

Senator DODD. I just raised the point. I've always been very supportive, as you know, of these programs. I never thought they ought to receive such an advantage over private operators to the extent that he's able to get as much as $1,000 for rent. On a family basis, the differential is incredible, better than 2 to 1.

Mr. ABRAMS. I agree with you, Senator. And we've made changes in building up the pipeline of the section 8 new and sub rehab program that we hope will preclude that from happening again.

But it's a complicated function of the fair market rents, which are neither fair nor market, and a number of other devices that were developed within HUD in the late 1970's to drive the program toward production, without any consideration of need in the community.

Senator DODD. I am not going to pursue this here, but I would like to follow up with some possible suggestions that HUD may have on how to correct that kind of situation occurring in the future, since we have got a lot of section 8 units out there, for a number of years to come. And I would like to minimize the possibility of that kind of gouging to occur. So I will terminate my question here, Mr. Chairman. Thank you.

Senator TOWER. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman. Let me commend you for holding these hearings, and welcome Secretary Pierce to our committee.

Mr. Secretary, thank you for laying out, I think, quite succinctly, all the things the administration has done, and, Mr. Chairman, I would ask unanimous consent that some remarks I have appear at the appropriate point at the beginning of our hearing this morning.

NEIGHBORHOOD DEMONSTRATION PROJECTS

Mr. Pierce, I would like to direct your attention to the Neighborhood Development Demonstration Act. My understanding is that HUD has some reservations about this bill. It doesn't have very much money in it. It's a $15 million, 3-year authorization, only $2.5 million in fiscal year 1983 and I suppose, just to clarify what your thinking is, that it would be truly helpful if I could have the opinion on whether or not you agree that neighborhood groups have been effective in spurring development and creating jobs.

Do you feel, on balance, they have been effective?

Secretary PIERCE. Yes. I would say neighborhood groups have been effective. When I say that, though, I want to quickly add that I think they have been effective by working in the neighborhoods and working with private organizations, particularly with private business and with their own local governments, in bringing about various kinds of business and job opportunities.

Senator HEINZ. I would agree with you. HUD contracted for a study with the Urban Institute, and it is my understanding that that study says, in part, that many neighborhood demonstration projects were highly successful in producing specific intended outputs through housing and community development efforts. They were more successful than others. The organizations effectively leveraged NSHD grants, obtained large amounts of other funds and monetary resources consistent with expectations. They were enormously successful in directing project benefits to people within their own communities, and obtained some significant project assistance in the residents 'self-help efforts.

I know you support leveraging. I know you support neighborhood self-help efforts. Let me ask you, further, do you believe that these kinds of neighborhood groups have been severely affected by cuts in such Federal programs as CETA, VISTA, community service agency grants, and others?

Secretary PIERCE. They would have to be somewhat affected, but I really do not think they have been too greatly affected, because I think they may have still been able to do a great deal along the lines that I stated earlier, with private business and various other private organizations, in particular neighborhoods, and with their own local governments.

Senator HEINZ. Perhaps you could comment—either now or later—you may or may not have seen this study, the U.S. Catholic Conference's Campaign for Human Development, did a survey last year. They released this July 15, 1982, on the impact of Federal budget cuts on CHD-funded organizations.

In answer to the question, "Were the organizations affected?" and I quote: "The vast majority, 80 percent, stated that their organization had been affected by the budget cuts." How deeply they were affected can be judged by the fact that 46 percent of the respondents had lost staff. Half of these, let us say 23 percent of all respondents, had lost more than half their staff.

In other words, more than 1 out of 4 organizations funded by CHD had lost more than half of their staff in the past year; 41 percent had eliminated programs, especially housing rehabilitation and treatment programs were most frequently being mentioned as eliminated. That study was conducted early in what would have been for us fiscal 1982. It is now probably much worse in fiscal 1984.

Let me ask you, if you would, to take a look at that. Do you have any information updating it? We would appreciate that. I suppose that really leads me to my next inquiry, whether or not you would agree, if you agree—of this survey—that neighborhood groups should be given some help in making a transition to greater self sufficiency. That is the objective of our bill. How do you feel about that?

Secretary PIERCE. Frankly, I worry about a national bill to help neighborhood organizations, because I think it may be opening a Pandora's box to start a great deal of money flowing to neighborhood organizations. Just 2 years ago, we stopped neighborhood self-help programs in HUD. There was a lot of criticism of them. One of the biggest criticisms was that the Federal Government was working directly with neighborhoods and bypassing local governments, which mayors and councilmen and others in local government did not appreciate.

I think it is something that has to be very carefully looked at, because I certainly do not think that we would like to, at this time, spend a vast amount on these programs unless we are absolutely certain that they can be extremely effective and do something that we need to help our economy—and not merely increase the deficits which we are trying to hold down, and which are so essential to keep in line if we are to turn around this economy and make it strong and viable.

Senator HEINZ. Maybe we could work with you on that, Mr. Secretary. As I say, this is a program that has a maximum authorization of $15 million.

Secretary PIERCE. That's not very much in and of itself. No, that's very little. But what I worry about is what will happen in the future. I notice that's just a demonstration program.

FOOD STAMPS COUNTED AS INCOME

Senator HEINZ. A 3-year program, maximum grant is $50,000.

Let me turn to a second subject. Is my understanding correct that HUD is planning to renew its proposal that food stamps be counted as income, as part of rent determination?

Secretary PIERCE. We are not renewing that proposal, but it is in the Agriculture proposal.

Senator HEINZ. That is to say, the Agriculture Department supports it? And you're what, for it, against it?

Secretary PIERCE. We would be for it. We would be for what the Agriculture Department seeks.

Senator HEINZ. How do you address the issue that since the poorest people get the most food stamps, they would have the largest amount counted against their rent determination, and would be forced, therefore, to pay the highest increase in rent? How does one square that?

Secretary PIERCE. One squares it by looking at food stamps and concluding that they're the equivalent of income. If you don't have to pay for food, then the amount that you don't have to pay is like receiving income. That income is then counted.

If you could get some other family who is not on food stamps for one reason or another, and who have the same income, they would not have the same amount of money, because they would have to buy their own food.

Senator HEINZ. There is an assumption there that the Federal food stamp program results in a 100-percent income replacement with respect to food for all categories of needy people. It is, unfortunately or fortunately, as the case may be, a scaled program. It does not reflect a 100-percent replacement, as I understand it, so that it would seem to me that even taking food stamps into account, the lowest income people would still be poorer than people who had more income.

Secretary PIERCE. I agree that these are factors to be considered, but basically the idea is that food stamps give somebody income leverage. I think that is true. If you have food stamps, it's equivalent to some extent—it has got to be equivalent— to money. How much, maybe, you could argue about. What the impact is, maybe you could argue about, but it certainly to me is the equivalent of money. It has the equivalency of money.

MORTGAGE DELINQUENCY RATES

Senator HEINZ. Mr. Secretary, finally, I would just like to bring to your attention the latest information on mortgage delinquency rates. It appears now that the December 1982 information is available that mortgage loans in all categories—FHA loans, VA loans, conventional loans—delinquencies continue to rise alarmingly. For conventional loans, they have risen in the last year from the middle of 1981 from 3 percent to 4 percent. In the case of VA loans they have risen from 5 percent to now 6 percent. In the case of FHA loans, they have risen from, I would guess, 6¼ percent to a little over 7 percent. The lines are sharply upward.

Are you concerned that these delinquency rates are going to continue to increase, No. 1, and No. 2, be followed by foreclosures, as they usually are?

Secretary PIERCE. Well, actually, I really believe that later this year the situation will improve, and I am going to put into the record here—I will file it for the record—some foreclosure rate statistics that we have covering the years from 1960 right through 1982. I think when you look at those you will find that we were in much tougher positions in the early to mid 1960's and early to mid 1970's. I don't have the Great Depression figures here, but they were awful.

I think we are coming out of this. As the economy gets going, I think we will get out of this. I believe delinquency rates are high, that's true. You have got to take those delinquency rates and look at them in context with the foreclosure rates, because you will find that a lot of banks are making deals with people to prevent them from going into foreclosure. They are delinquent, but they are making deals to carry them until they can get on their feet. There's a lot of that going on. So we have got much higher delinquency rates than the foreclosure rates.

But I think the situation is going to improve. I don't think it's anywhere near where it was in the early to mid 1960's and 1970's.

Senator HEINZ. My time has expired. Mr. Secretary, thank you.

Senator TOWER. Senator Riegle.

HOUSING FORECASTS

Senator RIEGLE. Thank you, Mr. Chairman. I have several things to deal with today. Mr. Secretary, last time you were here we discussed housing forecasts, and the housing needs in this country in terms of additional housing production, and at the time, as I recall, the Department did not have a numeric forecast on what it thought would be needed in the way of housing. You made a reference to the RAND study done in 1981. The RAND study, as I understand it, focused on rental housing demand and did not try to project the need for low- and moderate-income housing.

I have taken a look at what other experts in the field are projecting in housing demand for the rest of this decade. Kenneth Rosen, chairman of the center for Real Estate and Urban Economics at the University of California at Berkeley, projects an annual need for new housing units of between 1.8 million and 2.7 million units. This is based on population growth forecasts, household formations, the replacement demand as housing falls out of the housing stock, and so forth.

John Weicker, director of the housing and financial markets urban program at the Urban Institute, has projected a demand for between 24 and 27 million new units through the 1980's.

As nearly as can be determined, a consensus of housing forecasters in the private sector project the need for somewhere between 21 and 23 million new housing units in the 1980's. That would give us an annual rate of 1.8 million to 2 million units.

I would like the Department to give us a formal estimate, the best estimate you can make, as to what the housing needs are in terms of new units being produced throughout the next decade, with whatever background information you want to provide. I want to have a clear understanding of how you perceive future housing needs and what that judgment is based on.

I would ask that that be prepared by the Department and given to us as soon as possible.

Secretary PIERCE. We will prepare that.

[Requested information follows:]

Estimates of Potential Housing Demand and of Potential Housing Supply in the United States, 1980 to 1990

The history in the 1960's and 1970's of actual housing demand due to net household formations, replacement of inventory losses to house continuing households, and adjustments in the vacant stock is shown below, together with estimates of the projected potential demand in the 1980s.

Average Annual Changes
(in thousands of units)

			1980-90	
	1960-70	1970-80	Low est.	High est.
Net Increase in Households	1,042	1,693	1,300	1,500
Replacement of Housing Losses	614	525	660	840
Vacancy Adjustment	-7	279	130	150
Total	1,649	2,497	2,090	2,490

Because of the very low real cost of housing in the 1970's and high levels of housing supply, households formed at an unprecedented rate. While the population increased by 11 percent, households increased by more than 25 percent, and average household size decreased from 3.14 persons in 1970 to 2.76 persons in 1980. Also, in the 1970's the housing loss rate declined to an annual average of 0.86 percent from an average of 1.05 percent in the 1960's, as conservation and preservation of housing became more important.

In the 1980's, the high real cost of housing suggests that household formations will decline to the 1.3 to 1.5 million range, and the housing loss rate may also decline further. These estimates assume a projected loss range of .75 percent to .95 percent. They also assume that the proportion of the total inventory which will be vacant in 1990 is similar to that observed in 1980, and the large growth in vacant stock which occurred in the 1970s will not be repeated.

Past experience in the supply of housing, and the estimated supply projections for the 1980's, are shown below.

Average Annual Changes
(in thousands of units)

	1960-70	1970-80	1980-90 Low est.	1980-90 High est.
Total New Production	1,587	2,072	1,775	2,050
New Conventional Construction	1,381	1,705	1,525	1,700
Single Family Completions	920	1,095	1,025	1,150
Multi-family Completions	461	610	500	550
Mobile Home Placements	206	367	250	350
Housing Units Added From Sources Other Than New Production	196	457	315	450
Total Additional Housing Supplied	1,783	2,529	2,090	2,490

Housing supplied from all sources increased tremendously in the 1970's over the 1960's. In the 1960's, conventionally-built housing supplied 77 percent of additional housing, mobile homes 12 percent, and other sources (e.g., conversion of non-residential structures to residential use, subdivision of large housing units into smaller housing units, and restoration of abandoned or uninhabitable housing units) added 11 percent. In the 1970's, conventional new construction increased, but its proportion of the housing supplied declined to 67 percent, as mobile home placements accounted for over 14 percent and other sources added 18 percent (other sources added 28 percent in the period 1973 to 1980).

In the projections to 1990, other sources are conservatively estimated to add 15-18 percent of the supply, both well within the range of recent experience. Mobile home placements are projected to provide 12-14 percent of the supply. Both of these proportions are also justified by recent experience. Conventional housing completions are projected to provide 1.5 million units, or 73 percent of the total supply at the low demand estimate, and 1.7 million units, or 68 percent of the total supply at the high demand estimate.

Senator RIEGLE. I appreciate that.

On UDAG's, I think it's fair to say that that program has enjoyed about as much support here in the Congress as any program under the jurisdiction of HUD, as you well know. That support has been bipartisan. It has been active. When proposals were made early in the administration to cut UDAG, there was a bipartisan decision not to do that, and to maintain the program.

And I think it has stood very well the test of time. Certainly in my State, and other colleagues' States as well. You have requested to defer $244 million in Action Grants funds for fiscal year 1983 to be used in the new budget for fiscal year 1984. I understand as well that if the Congress does not agree with this deferral as the House has not, your inclination would be, as a Department, to nevertheless request a lower funding level next year, which would mean a substantial reduction in UDAG funding.

What I don't understand is why this money has not been spent. I have the feeling that there are a vast number of cities across the country that are standing in line, that have projects they want to go ahead with. They feel the need to go ahead with it, yet the allocations haven't been made.

I am just wondering how many applications are pending today for HUD funding, particularly in small cities money, that could perhaps be granted so that this money, which has been provided, could be spent.

Secretary PIERCE. Well, that was the problem. The problem was that during the past year, particularly in small cities, we have not been able to get good applications, and the reason we haven't been able to get good applications is because of our economy, I think, primarily, because the businesses do not want to move into those communities. They can't leverage the private businesses, which is absolutely essential to get a UDAG grant. And they just can't get the businesses to come in.

So that has been our big problem. That's one of the reasons we haven't been able to get the money out. There are other reasons, of course, but I think that is a principal one.

Senator RIEGLE. I wonder if in a situation of changed conditions, and a serious recession, that perhaps it might require a reevaluation of your own yardsticks.

Maybe the leverage factors have to be reduced. These funds are need by small cities for revitalization and for a new economic foundation.

I know you feel that that is necessary. Do you think it would be better to perhaps revise our criteria so that some level of economic activity could go forward?

Secretary PIERCE. We have that under consideration right now. We're thinking about that. But we also have to think about this.

SUPPORT OF PRIVATE LEVERAGE CRITICAL

The whole idea of a UDAG is that you leverage the private sector. If you once get out of that, you don't have a UDAG program. You have something else.

We will be giving small cities something else if we get too far away from private leverage. We've made much in our department about the leverage we get on private business.

We're proud of that. We go around and we talk about it.

It was one of the ways which I was able to sell this program to my own administration.

If I start taking away that private leverage, then private business is really not as active as we've been saying, and we're going to have a tougher time selling UDAG.

Senator RIEGLE. I understand that. We all support private leverage. It has been a critical feature of the program in terms of why it's worked and why I think it's proving its success; and that there's nothing magical about a 6-to-1 ratio, or a 5-to-1 ratio.

Secretary PIERCE. We got 6 to 1. But really the ratio that we have by regulation is about 2½ to 1.

Senator RIEGLE. Are you saying you do not have any small city that would meet the test of 2½-to-1 ratio?

Secretary PIERCE. We don't have overwhelming numbers. We do have some. And we're processing them in the normal manner.

But we've had a number of them. Many have fallen out of the pipeline, so to speak, because they haven't been able to get sufficient pvirate sector support.

Senator RIEGLE. My concern is this. We're at a point where we want to try to give the economy as much chance to recover as possible.

In many cases, small cities are struggling to survive. I would have a clearer picture of how many small cities have not met the leverage criteria, and have for for one reason or another not been approved.

Secretary PIERCE. Leverage is a very important reason. But there are other reasons why we don't get it, too. We have, I think, a very good group working on this, because they have worked so effectively, and have been economically efficient, and honest in their approach.

That's why Republican, Democrat, Conservative, Liberal, everybody likes the UDAG program. It's been a very well-run program.

There are a variety of reasons why some localities do not get a UDAG. But one of the big reasons, as I said, has been the private leverage problem with the smaller cities.

Senator RIEGLE. Let me just conclude by saying that there is a rising concern in Congress that despite the fact that you may be a supporter of UDAG, there are others in the administration who are not.

OMB has made it clear that they would like to eliminate the UDAG program.

The fight has been to keep it a separate program and fully funded. There is suspicion that the money is not being spent that could be spent, partly to restrain the deficits and to squeeze it down in size.

The same concerns were expressed with respect to the appropriation of $2.5 billion for public housing modernization funds in fiscal 1983.

HOUSING APPROPRIATIONS BEING HELD UP

As nearly as I can determine, none of the money for fiscal year 1983 for public housing modernization has been spent, even though we are almost halfway through the year. And apparently the rules and the regulations are in the process of being revised to forestall the movement of this money for some additional number of weeks and months.

I'm concerned about it because the intent of the Congress, I think is clear, to not only move on housing rehab and modernization in this way, but also to create jobs and to do so quickly.

I also understand that on February 9, Assistant Secretary Abrams sent a memorandum out to the regional HUD offices announcing that there were going to be major changes in the procedure for approving funds for modernization projects.

So it looks now as if more months are going to roll by before we get any of this money moving through the pipeline the way the Congress intended.

Can you give us a report on that, and tell us what is being done to move this money out rapidly?

Secretary PIERCE. Do you want us to give you a written report for the record?

Senator RIEGLE. I guess I would like you to be able to tell me that there has been a breakthrough and the money is being spent. And the picture is not as frozen as it sounds.

Secretary PIERCE. We'll give you a full written report, but I want to say right here and now that I urge and push my staff to get that money out, and we intend to have it into the field and working.

Sometimes we have holdups for one reason or another, and we have problems, even after we give the orders to get the money out.

My view is to push and get the money out.

Senator RIEGLE. Well, we want to help you. I would appreciate it if you could give me an estimated timetable of how much of that money is actually going to be used in the coming months. I do not want to see the funds trapped in a sea of changing regulations and paperwork, and shifting of decisionmaking responsibilities, so that time just rolls by. The money is needed to get the work done.

I want to just raise one other thing here. There are others here who are waiting to use their time. Do you know there are presently 430,000 publicly owned housing units across the country which are over 20 years old, and need to be upgraded?

You've seen these, and I know it's a concern of yours as well. There have been a number of studies done. One HUD study by Perkins and Will in 1980, estimated that the capital investment required nationally to bring these public housing projects up to an acceptable standard of efficiency and habitability would be about $10.5 billion in 1983.

Other groups have also taken a look at this. If we were to do this over a 5-year time frame, it would require something between $2 to $4 billion a year.

Yet your budget has cut modernization funds from $2.6 billion in 1983 to $1.4 billion in 1984.

You propose to phase out the program by 1988 claiming that the transitional modernization program will bring all the units up to standard.

As we do this analysis, it looks as if you are walking away from the problem without really responding to it in the dimension to which it actually exists.

I would appreciate your comments on that.

Secretary PIERCE. Actually, we do not believe we will bring all of the units up to standard quality. There are a number of units, for a variety of reasons, that cannot be brought up to standard quality.

We believe that over time, over the next 5 years, we will lose about 100,000 units. So we are not going to make all of these units standard quality.

Also the amount of money we're asking for, although the modernization amount may be down somewhat, we are asking for more money in a sense because we are changing our formula from the PFS formula to a fair market rental formula.

And there'll be more money along with a replacement reserve given to the PHA's. So you have to take that into consideration to find out how much money is really being given, which is quite substantial. Particularly in the early years 1984 and 1985.

But we do not intend to bring every unit up to standard quality. There are many reasons why that can't be done.

Some of them would require being completely built all over again, to be brought up to quality. And we can't do it.

There are other reasons. Because zoning laws are something, they can't be rehabilitated any further. There are all kinds of reasons why we can't.

Senator RIEGLE. My time is up. Thank you.

Senator TOWER. There is a vote on the Senate floor. Therefore, I will suspend for 10 minutes.

[Recess.]

Senator TOWER. The committee will come to order. Senator Riegle would like to ask a couple of more questions, Mr. Secretary. Then if there are no other questions——

Senator RIEGLE. Thank you, Mr. Chairman. Senators Sasser and Lautenberg I now have questions.

Senator TOWER. And Senator Heinz also wanted to submit questions.

FAIR MARKET RENTS

Secretary PIERCE. We'll answer them for the record.

Senator RIEGLE. Mr. Secretary, HUD calculates fair market rents as the basic control for housing assistance under the major section 8 housing program. HUD then pays the difference between the rent of a family of four—and the fair market rent.

Fair market rents have not been adjusted since March of 1981 and in fact have been reduced by about 16 percent in real terms.

I would like you to comment and clarify on my understanding of your proposals.

Previously the FMR has been calculated at the 50th percentile of previously rented apartments. HUD is proposing to reduce that to the 40th percentile of all standard apartments in the locality. This would reduce the fair market rent standard by 15 percent.

Currently landlords do not charge more than the fair market rent. HUD would take off that cap and require tenants not only to pay 30 percent of their income, but also any rent above the FMR standard. At the same time President Reagan's Housing Commission found that people holding housing certificates had a hard time finding housing, even under the earlier fair market rent levels.

In fact 72 percent of the minority tenants and 52 percent of nonminority tenants failed to find adequate housing after 60 days of looking. Lower fair market rents will make that situation worse.

I am wondering what evidence there is that assisted housing tenants are not going to be increasingly concentrated in poor and declining neighborhoods as a result of these new proposals. It is a concern that I have and I think we could be moving in the wrong direction.

What is your reaction to these concerns?

Secretary PIERCE. Well, actually, I don't think they will be ghettoized more than they are right now. If you'll travel around the country and look at public housing facilities, city after city, you'll find they soon become ghettoized.

In New York you can look at a lot of public housing and if you find one or two white families, that would be a heck of a lot. Most of the tenants are black and Hispanic, so I think that we are in a position right now of having heavily ghettoized public housing and public facilities.

So what I really believe—and what we have found to a large extent through some of the observations we've made of our own existing section 8 program—is that people are able to get out of the ghettos better with certificates than with public housing.

Public housing tends to establish more and more ghettos. You mentioned that a lot of families are not able to find a place to live with a certificate. I think that when you analyze that even more you'll find that they are large families that can't find places.

We are looking into that. It's the larger families who have problems finding places in the cities to live. That is true whether you have a certificate or not. We have large families trying to get into a limited amount of space, and we have long public housing waiting lists everywhere.

So that is really what is happening. I guess my conclusion is that I cannot agree with the presumptions that you make.

Senator RIEGLE. Before I yield to Senator Sarbanes, I want to cite some data, both for you and the record. It comes from the Department. Data from President Reagan's Housing Commission has shown that there is a problem for families with a number of children, large families, as you say. But the percentage of those who could not find housing with certificates is just as high the smaller families.

Let me just give you the percentages. I'm going to give them to you both for minority and nonminority. This is your own data: Elderly couples, minority, 66 percent have found that they could not find housing within 60 days. Younger couples: 67 percent. One parent with one to three children: 75 percent. One parent with four-plus children: 78 percent. Two parents with one to three children: 63 percent. Two parents, four-plus children: 72 percent.

These are extraordinarily high levels and think you have a serious problem. The same is true of nonminority: Elderly couples, 50 percent could not find housing; younger couples: 45 percent could not find housing. One parent with one to three children, 56 percent could not find housing. Two parents, one to three children, 57 percent could not find housing. It jumps up——

Secretary PIERCE. May I just make a couple of observations on that. Don't forget that is 60 days, but the main observation I want to make is that we have never gotten back one certificate from a PHA; not one existing housing certificate has ever come back to us.

They've never given a single one back; they've always been able to use it.

Now, if they've been able to use all of the certificates issued to them, we don't see the problem you're talking about as clearly as you do. It seems to me if that were a problem, we'd be getting loads and loads of certificates back. We don't.

UDAG FUNDING LEVELS

Senator TOWER. Senator Sarbanes.

Senator SARBANES. Mr. Secretary, I know you've been asked earlier this morning about the UDAG funding levels, but I want to make sure I understand exactly what your position is.

As I understand it, you're committed to funding UDAG at $440 million in fiscal 1984, 1985 and 1986; is that correct?

Secretary PIERCE. That's right.

Senator SARBANES. For fiscal 1984 the Administration's request is for 196. I take it you're going to have a supplemental or budget amount in addition to the 440?

Secretary PIERCE. No, we're just going to add funds appropriated but not used in prior years.

Senator SARBANES. You're going to do what?

Secretary PIERCE. It'll be a carryover.

Senator SARBANES. What are you carrying over, the 244 from fiscal 1983?

Secretary PIERCE. Yes.

Senator SARBANES. That's included in——

Secretary PIERCE. I'm sorry. It's 1981 and 1982.

Senator SARBANES. That's included in the Jobs bill, isn't it?

Secretary PIERCE. We're carrying it over from 1981 to 1982. As I understand it's $244 million.

Senator SARBANES. Isn't that money included in the Jobs bill?

Secretary PIERCE. Let me ask my finance man. I don't believe so. This is Mr. Kliman, my finance officer.

Mr. KLIMAN. Senator Sarbanes, the $244 million which the administration proposed for deferral is presently being overturned in the pending Jobs bill. If that Jobs bill is enacted, then the $244 million will be made available.

Senator SARBANES. In fiscal 1983?

Mr. KLIMAN. That is correct.

Senator SARBANES. What will be the funding level of UDAG in fiscal 1984?

Mr. **Kliman**. The funding level in the budget is $196 million for 1984 plus whatever still carries over from 1983.

Senator **Sarbanes**. So you're not going to fund it at 440 unless you have a carryover?

Secretary **Pierce**. Let me say this. We will, if necessary, ask for a supplemental. The 440 is where we're going to go.

Senator **Sarbanes**. You're committed to 440?

Secretary **Pierce**. That's what I want.

Senator **Sarbanes**. And whether or not you have a carryover to help you achieve it?

Secretary **Pierce**. Whether or not.

Senator **Sarbanes**. Thank you.

I wanted to ask also, are you proposing, or do you have under consideration eliminating housing as an authorized activity under the UDAGs?

Secretary **Pierce**. We're now limiting housing under UDAGS. We're emphasizing commercial and industrial use. You can have housing if it is in combination with a commercial or an industrial project.

Senator **Sarbanes**. Has there been an abuse or the commitment of UDAG funds to housing?

Secretary **Pierce**. No, I wouldn't say there's been an abuse, but we want UDAGS to emphasize more commercial and industrial use. We want to emphasize jobs and improvement of economic conditions in localities.

Senator **Sarbanes**. What percentage of the current UDAGs have gone for housing?

Secretary **Pierce**. This year's?

Senator **Sarbanes**. Any years. What is it that prompts you now to limit housing under the UDAG program.

Secretary **Pierce**. The economic situation we live in prompts me now.

Senator **Sarbanes**. Prompts you to do that? How does it prompt you?

Secretary **Pierce**. I think we can use the money better to spur economic activity in localities than having it used for housing.

Senator **Sarbanes**. What's the factual base for that judgment? How much of the UDAG money has been used for housing?

Secretary **Pierce**. You mean what is the factual base? The terrible recession we've been in is the factual base, but we can get you more data, if you'd like.

Senator **Sarbanes**. How much of the UDAG money has been used for housing?

Secretary **Pierce**. I would have to get that; I don't have it directly at my fingertips.

Senator **Sarbanes**. Here's an authority the localities had. Some of them have made effective use of UDAG money in the housing field and have in fact created jobs in the construction industry at a time of very low production.

You're now proposing to cut back on that discretion. That runs directly contrary to what the President constantly asserts about giving greater discretion or more leeway to State and local people to make their own decisions as to how to use the money.

Secretary **Pierce**. They can get it out of CDBG grants.

Senator **Sarbanes**. What's the rationale for that?

Secretary **Pierce**. The rationale for that is this: We believe that there are areas or pockets where there is a lack of rental housing. We intend to try to relieve that situation through a rehab program that we have suggested plus allowing communities to use CDBG funds for construction.

Senator **Sarbanes**. So you're proposing to broaden their discretion on CDBG to embrace new residential construction; is that correct?

Secretary **Pierce**. Yes.

Senator **Sarbanes**. At the same time, however, you're proposing to limit or curtail with respect to the UDAG.

My question is really, Why are you going in two directions at the same time?

UDAG FUNDS FOR INDUSTRIAL AND COMMERCIAL PURPOSES

Secretary **Pierce**. Because we think that the UDAG funds are best used for industrial and commercial purposes. Also UDAG does not flow to everybody; it's a competitive thing. It only goes to some communities while housing is more of a general thing which we can get through the community development block grant——

Senator **Sarbanes**. I understand that.

Secretary **Pierce**. But a UDAG is a special thing.

Senator **Sarbanes**. Which you have to approve?

Secretary **Pierce**. Yes.

Senator **Sarbanes**. Well, why would you remove from the UDAG competition the possibility of rental use?

Secretary **Pierce**. I think I told you that, Senator. You disagree with it but I told you.

Senator **Sarbanes**. You've told me your conclusion. You've not yet given me the basis for it.

Secretary **Pierce**. I said we will supply economic data for you.

Senator **Sarbanes**. Which will demonstrate what?

Secretary **Pierce**. Which will demonstrate my conclusions.

Senator **Sarbanes**. I want to know what kind of data we're going to get, Mr. Secretary. What is it that you're going to supply?

Secretary **Pierce**. My office will supply data that will show how cities have benefited more through commercial and industrial use in the sense of an improvement in their economies.

Senator **Sarbanes**. Since you have the discretion to pick these UDAG grants, I don't understand why you don't allow them to continue to compete if they can put together a good residential project with a high leverage, again, with a lot of jobs. That's essential to some other purposes.

You don't have to give it to them—you make a fairly good point on the community development block grant—if it's precluded as a legitimate use of the money. You're addressing that on the UDAG. You passed judgment on their merits.

If someone comes in with a very meritorious UDAG that embraces within it residential housing, I don't see why you ought not to include it at the outset.

Secretary **Pierce**. It can have residential housing in it if it is tied to a commercial or industrial——

Senator SARBANES. But you're not going to preclude any project that has only residential housing?

Secretary PIERCE. Yes, we are.

Senator SARBANES. No matter how meritorious it may be?

Secretary PIERCE. Yes. That's the way we want the program to work.

Senator SARBANES. You'd better give me the kind of data to back the arbitrary——

Secretary PIERCE. We'll send that to you.

Senator SARBANES. I'd like to see it.

Secretary PIERCE. OK.

[Requested information follows:]

RESPONSE TO QUESTION OF SENATOR SARBANES

Question: Provide UDAG Data in Support of the Decision to Exclude Housing-Only Projects.

Answer: This Administration has given the UDAG program a sharper focus on economic development. This translates into job creation and fiscal benefits for distressed cities.

Prior history with the program demonstrated that industrial and commercial projects did a better job of generating permanent jobs than did neighborhood projects which include housing only projects. Commercial and industrial projects also did a better job of increasing the tax base of distressed cities. The following data illustrate the point regarding job generation:

Project Type	New Permanent Jobs
Industrial	113,576
Commercial	199,379
Neighborhood	46,125

To further emphasize the primary focus of the program the Department encouraged industrial and commercial projects by eliminating from the law that UDAG fund a reasonable balance between neighborhood, industrial and commercial projects.

As a consequence of the movement toward job creating commercial and industrial development projects, the effeciency of job creation in the UDAG program in constant dollars has increased from 187 to 225 new jobs per million dollars of UDAG money.

Senator **Sarbanes**. On your public housing, the Congress provided \$2½ billion for the modernization of public housing in 1983; is that correct?

Secretary **Pierce**. For the modernization in fiscal 1983? Yes, I believe that's right.

Senator **Sarbanes**. What's happened to that money?

Secretary **Pierce**. It's been put out into the various regions to be given to the PHA's who get the money.

Senator **Sarbanes**. Is that right? It's ready now to be given to the PHAs?

Secretary **Pierce**. Yes.

Senator **Sarbanes**. Those approvals are not being held up?

Secretary **Pierce**. No.

Senator **Sarbanes**. Have any of them been made?

Secretary **Pierce**. I'll ask my Assistant Secretary for Housing, who has the job of actually distributing them.

Mr. **Abrams**. Senator, the process for modernization fund distribution is a discretionary funding process. The funds are appropriated in December, apportioned as in January, and distributed to the field offices on February 9. At that point the process starts whereby the field offices solicit requests from the various housing authorities based on their modernization needs.

That process goes on through preliminary applications, final applications, final review, and then ends up in amendment to the annual contribution contract.

It typically takes—in a normal year, even if we got the money appropriated in September, it normally takes till the following January for that cumbersome process to take place. That's about 15 months.

We are accelerating that process and we will be sending out a notice telling the field offices to move up their review. We're giving them the discretion to reduce the review time to reduce the amounts of applications and the back and forth procedures, so we can hopefully get the annual contribution contracts signed by September 30.

Our thrust in producing jobs has concentrated on the \$2 billion worth of modernization funds appropriated in fiscal 1982 and prior years which have not resulted in contracts to accomplish the modernization.

We are going to the various field offices. We started in Philadelphia last Thursday and we'll be going to the offices that have the largest backlog of unexpended modernization funds to cut the redtape to allow the housing authorities to move more quickly to provide for the modernization, so we can update public housing as well as provide jobs in the process.

Senator **Sarbanes**. At what level is this rehabilitation going to take place? What standard will you use?

REHABILITATION PRIORITIES

Mr. **Abrams**. The standards right now require that the first priority is for emergency modernization for items that threaten health and safety: lead-based paint. The second priority is for special purpose modernization which involves energy conservation. The third level provides for comprehensive modernization.

We are proposing and we have asked for the submissions this year to be done on a two-track basis, both on a comprehensive basis which would bring the public housing authorities up to level 3 as defined in the Perkins and Will study, which is basically to a level of modernization that we thing is excessive, as well as to make submissions to bring the housing authority units up to the safe and decent housing standards as defined by the housing quality standard use in the section 8 existing certificate program.

We believe that we are appropriate in moving regulations along at the same time that we have this dual track application procedure going on so that we can assure that we will bring every housing authority up to safe and decent housing standards and implement energy conservation modernization before we bring any projects up to a level that brings unnecessary amenities to the housing authority projects while there are still substandard units in federally paid for buildings with federally subsidized tenants who are not living in units that meet anyone's definition of safe and decent housing.

Senator SARBANES. So, in your comprehensive modernization, you're not encompassing the notion of really extending the economic life of the unit.

You're talking about going to minimum code standards; is that right?

Mr. ABRAMS. That's not correct.

We're proposing to extend the economic life of these housing authority projects by bringing them up to the same standards we set for the private sector.

We'll provide housing for low-income families, particularly the 750,000 families that have section 8 existing certificates.

We think it's important to bring every public housing unit—every substandard public housing unit up to that level before we start to bring money to bring housing authority projects up to level 3, Perkins and Will, which we think provides amenities which aren't necessary.

Senator SARBANES. Is that the premise on which the PHA's have submitted their applications to you?

Mr. ABRAMS. That's the premise we've asked them to submit.

Senator SARBANES. That's just going to delay things further.

Mr. ABRAMS. I beg to differ with you, Senator. They submitted it on a dual track basis, both the amenities that are allowed under level 3 of the Perkins and Will study, as well as on another track which we hope to use to bring all substandard and vacant units up to housing quality standard.

Senator SARBANES. In future years, you're proposing to do away with the modernization program and embrace it in another one; is that correct?

Mr. ABRAMS. We have a proposal for housing authorities that get at least the amount that they would get under the performance funding system to give them a replacement allowance equal to 20 percent of their allowable expense level.

That would give them a fund which they could use for deferred maintenance, repairs, modernization, or to put aside and use to provide for new facilities in the future. It would give those housing authorities discretion over how that money is used.

Senator SARBANES. How do they overcome the large backlog of modernization that is out there needing to be done and at the same time lick their operating problems?

If you had them up to standard—and we were talking about such an approach—I could sort of look at it.

But with this tremendous backlog of modernization problems that exist, I think everyone concedes that; is that correct?

Mr. ABRAMS. No. I don't think every are concedes that, because the other part of what we're proposing is that for those housing authorities that do not get the performance funding system level plus replacement reserves and then have structural problems—either due to energy-inefficient buildings or a great number of substandard units which we will no longer subsidize and vacant units which we will no longer subsidize, that we propose and have asked in our 10 percent of the public housing authorities that have serious problems and that cannot survive, with market rents including a replacement allowance. The Perkins and Will study, to get to the latter part of your question, said that in 1980 there was about $3.5—I think it's $3.9 billion—needed to bring housing authority units up to housing quality standards and to make them energy efficient.

We have received, from 1980 to 1983, $3 billion. By retargeting, we can accomplish that and provide the additional $900 million that Perkins and Will identified by those standards in the next 4 years out of the $3.4 billion that we've asked for in this authorization bill request, as well as what will be requested for the following 3 years.

Senator TOWER. Senator, I'm sorry. Your time is up. We can return to you, but I should give Senator Lautenberg a turn.

Senator SARBANES. Fine.

Senator LAUTENBERG. Thank you, Mr. Chairman.

Mr. Secretary, I noticed in your comments, in the text that you submitted here, in one area you say that HUD research shows while population of new construction in housing—the racial composition of some neighborhoods in some cases were perpetuating segregating but in some families have used housing certificates to move to less segregated areas.

Later it says rehabilitation assistance will be targeted to low-income areas, where 80 percent of the rehabilitated units will be affordable and available to low-income families.

Aren't we saying two different things, the same thing with different words here?

The fact is where these people find the housing units is likely to be in the segregated neighborhoods.

If you look at Newark, N.J., I don't know where people are going to go with these vouchers to find an opportunity to move into a less segregated neighborhood. I don't really see how we're accomplishing that purpose. If it shouldn't be in here, it shouldn't be in here.

Secretary PIERCE. If you take a city like Newark, what's the population there of blacks and Hispanics?

Senator LAUTENBERG. 350—I'd say 60 to 70 percent black and Hispanic.

Secretary PIERCE. You've got a hard time then.

But in a city where there's more equality and balance of the races and fewer blacks and Hispanics, you have a better chance.

Senator LAUTENBERG. Certainly. This is not a ticket out of a segregated area.

Secretary PIERCE. Not automatically; no, sir.

But through our observations of our certificate program, under the section 8 existing housing, we have noticed that that has happened, much more so than in public housing.

Senator LAUTENBERG. Your budget request to OMB, September 15 last, suggested that rental rehabilitation programs should be at the $300 million level and include new construction.

The proposal before us now is $150 million, excluding new construction.

What's changed your thinking?

Secretary PIERCE. We didn't change our thinking. We had a battle with OMB, and we lost.

Senator LAUTENBERG. So, you didn't feel that that was something urgent enough to defend?

Secretary PIERCE. Oh, I felt urgent about it. We defended it. But these things go through a process, and you win or lose. We lost that one. We won some others, but we lost that one.

Senator LAUTENBERG. Lots of people lost with you, Mr. Secretary.

Secretary PIERCE. A lot of people won with me a lot of times, too

I can give you a lot of those, too.

Senator LAUTENBERG. In my background in statistics, statistically, I'd say we're worse off than we were, based on the programs we see designed by the present administration for poor and low-income people.

Secretary PIERCE. Take a look. When we came into office, assisted housing consisted of 3.2 million units. It went up to 3.5 million units in 1982.

It went to 3.7 in 1983.

It's going to go to 3.9 in 1984, and over 4 million in 1985.

Which means we are increasing, not decreasing, the amount of assistance we're giving.

Senator LAUTENBERG. Mr. Secretary, one side of that equation that's not in there is need. The need has gone up considerably.

Secretary PIERCE. The need was here in the sixties, sir, tremendous needs. The Great Society was operating, and we weren't getting enough assisted housing.

Senator LAUTENBERG. I don't want to use my time to question you for your time to question me.

I'm new here. But I'm beginning to learn the rules a little bit.

In your request to OMB, also, you indicated you'd cover rent increases in both federally insured 236 projects and State-aided noninsured projects in 1983 and 1984.

Since September, apparently, your thinking has changed, so that HUD no longer feels morally obligated to give equal treatment to both classes of projects.

NO INCREASE IN STATE AID TO UNINSURED PROJECTS

Failure to cover the increase in State aid to uninsured projects will result in substantial increases of over $2 million.

What's your current thinking on this?

Secretary PIERCE. My current thinking on this is that the States should handle the buildings that are not insured by the Federal Government. The buildings that are insured by the Federal Government should be handled by the Federal Government.

There are a couple of reasons for that.

First of all, when a building is insured by FHA, we have great control over how the building is rented, we have great control over economic restraint, economic discipline. We control a lot of the economics of that building.

Second, we have a responsibility to protect the FHA insurance fund.

Now, those two reasons tell me we should do something with respect to buildings that are federally insured. But why should we help the State buildings which are not under us, which we have not watched as they've grown and as they've been built?

We've had no control over their economics. Those buildings may be bad risks, which may invade the insurance fund and cost this Government a lot of money. Why shouldn't the States pay for it?

Senator LAUTENBERG. Am I wrong when I say, in your earlier request to OMB, you indicated State aid to uninsured projects would be covered.

Secretary PIERCE. We did submit that to OMB, but I have rethought that position. And I think I see it this way.

We did submit that, and I think we submitted it mainly because we were just trying to help out the States if we could.

But really, if we get down to it, I think the rationale that I gave you is proper.

Senator LAUTENBERG. How much of this job—what we like to do, in terms of covering the rental requirements, how broad do you think our attack ought to be here? How much are we missing in terms of what has to be done?

Secretary PIERCE. If you take the amount of people who would qualify for help, we are not covering all of those people by any means. But we have never covered all these people at any point in our Government's history.

In the time of Roosevelt, when this whole business began, through the Great Society, down to now, we have never covered all the people we should. We can't afford it. I don't think this Government can afford it.

We're going to try to keep our deficits in line. We're going to try to do what is necessary to have a budget that balances and to have an economy that reverses its downward trend and begins to grow strong. To do that we just can't afford to give housing assistance to everyone who may technically qualify for it.

Now, the Senate, of course, if you want to vote all that money for us, we'd be very glad to use it. But we don't think it's the right thing to do.

Senator **LAUTENBERG**. You're unfortunately in a position for the Department you represent, Mr. Secretary—ought to have as strong an advocacy as you can.

There are other balancing——

Secretary **PIERCE**. The Department I represent—I represent the President and this administration. And I believe that it is most important for us to get our deficits in line, to balance our budget, and to make sure that this economy grows stronger.

Because with the strengthening of our economy, the poor will benefit, the blacks will benefit, all people will benefit. And that is what my aim is.

And I'm going to try to do the best I can for the people of this country.

Senator **LAUTENBERG**. I don't doubt that a bit.

Secretary **PIERCE**. But we're going to try to do it with good sense. And we're trying to use the funds we have wisely.

Senator **LAUTENBERG**. You haven't designed a tax program to take care of it, and you haven't got the revenue sources that are available to you to take care of somebody's program.

So that when you take on, personally, the responsibility of balancing that budget, Mr. Secretary, I submit you have a bigger assignment.

Secretary **PIERCE**. It's not just personally. It's for every person who's involved to do the best he or she can.

Senator **SARBANES**. You're not bucking for Mr. Stockman's job if he leaves? [Laughter.]

Senator **LAUTENBERG**. Thank you very much, Mr. Chairman.

Senator **TOWER**. Any more questions for the Secretary?

Senator **SARBANES**. Yes.

Senator **TOWER**. Senator Sarbanes.

Senator **SARBANES**. Mr. Secretary ——

Senator **TOWER**. Paul, if you will yield for 1 minute.

It's my intention to stay in session for about another 10 minutes.

Then, we'll recess the hearings for the Policy Committee meetings of the two parties and then reconvene at 2:15, to hear from our panel on housing costs.

HUD ASSISTANCE COMMITMENTS

Senator **SARBANES**. Mr. Secretary, I was intrigued by the figures you were giving earlier on the HUD assistance commitments, as I understand it, that you said had been made. Was it 3.4 million, as I recall?

Secretary **PIERCE**. It was 3.2 in 1982. It then became 3.5 in 1982. 3.7 in 1983. It will go to 3.9 in 1984. And it will be over 4 million in 1984.

Senator **SARBANES**. Do those figures represent commitments?

Secretary **PIERCE**. Commitment. Excuse me.

Senator **SARBANES**. Do those figures represent commitments for assistance made under your administration or commitments having been made previously?

Secretary **PIERCE**. Under our administration.

Senator **SARBANES**. I have some figures in front of me that said the net new additions on assistance commitments in fiscal 1981 were 159,000. Fiscal 1982, 56,000. Fiscal 1983, estimated 59,000. Fiscal 1984, requested 81,000. Are those figures not correct?

Secretary PIERCE. Are they correct? From whose standpoint?

If these are our figures, they're correct.

Senator SARBANES. Let me ask this of the Department. What are the correct figures?

Secretary PIERCE. I just gave them to you. You can take the difference, 3.2, 3.6, 3.7, 3.9.

Senator SARBANES. Exactly what are those figures?

Secretary PIERCE. Those are the number of assisted housing units that we have outstanding.

Senator SARBANES. Were those commitments made by you in those years? Or were they in part, the realization of prior commitments?

Secretary PIERCE. When we started, it was 3.2. It was the prior years that did that.

Then, when we went to 3.5, that's our commitment.

Senator SARBANES. Is that right? Or is that a realization?

Are those outstanding? Or are those commitments made in that fiscal year?

Secretary PIERCE. Those are what we got——

Senator SARBANES. Mr. Abrams, I see, is anxious to respond. [Laughter.]

Secretary PIERCE. I'll let Mr. Abrams respond later.

But I'm talking now. And I say those are the figures that we caused to happen, because they resulted from budget proposals we have submitted since 1981.

Senator SARBANES. How many assistance commitments did you make in fiscal 1982?

Secretary PIERCE. Fiscal commitments?

Senator SARBANES. Assistance commitments did you make in 1982?

Secretary PIERCE. It would be the difference between the 3.2 and the 3.5.

Senator SARBANES. Is that right? You made 300,000 commitments?

Secretary PIERCE. That's what we acted on. Our number of units increased.

Senator SARBANES. Some of that was the realization of prior commitments, was it not?

Secretary PIERCE. Yes. But we could not have done it——

Senator SARBANES. You could have sat there and done nothing—and the figure would have gone up—simply by approving past commitments; is that right?

Secretary PIERCE. It would have gone up—not by that much, no.

Senator SARBANES. Not in 1982.

It would have been 56,000 additional that you made.

Secretary PIERCE. Well, let me have Mr. Abrams tell you something about that. He wants to tell you.

Mr. ABRAMS. When we came into office, the Secretary had initiative to bring the housing pipeline—and section 8 pipeline particularly—a regulation to provide a financing adjustment package.

When we came into office, because of the inflation and the effects of inflation on interest rates, it was impossible to build any of the projects in the pipeline.

The regulations to provide requests for amendment funds that were provided that year allowed for the previous pipeline that had been sitting and not resulted in subsidized housing units to go to construction.

And those units that are added as a result of that and are directly attributable to the initiatives, both regulatory and requests for funds by the Secretary, the same thing with requests for amendment funds for public housing development units that were brought on line.

The requests were not made, and the amendments were not provided. The projects wouldn't have moved forward to construction.

There is no fine line been obligations that have been made and have not resulted in provided assistance for low-income families and those housing units that result from occupied housing for low-income families as a result of administrative regulatory budget requests by the administration.

Senator SARBANES. Mr. Secretary, what do you regard as your accomplishments in the course of your tenure as Secretary, your major accomplishments?

REMOVAL OF SECTION 8

Secretary PIERCE. I regard many things.

Let's start—when I came here, I knew this right away, that there was a program called section 8 for new construction. That program and programs like it in the past were costing this Government a tremendous amount of money, unnecessarily.

Because of this kind of money being spent, there was a debt sitting out there—and still is out there—of $250 billion, a quarter of a trillion dollars, that you, your relatives, your future grandsons and daughters, and everybody will have to pay.

Senator SARBANES. I want to know what the assets are that you're setting off against that debt?

Secretary PIERCE. What are the assets I'm setting off?

Senator SARBANES. What are the assets that that debt represents?

Secretary PIERCE. Very little, if you really want to figure it out. But the point is it has to be paid by the taxpayers.

Senator SARBANES. What are the assets?

Secretary PIERCE. The assets are public housing buildings, section 8 buildings, and other federally assisted housing.

Senator SARBANES. Housing?

Secretary PIERCE. Yes.

And they still have to pay this debt that's sitting out there.

Senator SARBANES. You have to pay a debt.

Secretary PIERCE. No.

The point is this is way more than it should cost.

Let me give you just an example. I don't know whether you're a lawyer or not, but it's almost a joke among lawyers that every time a lawyer gets a section 8, he automatically gets $1,000 to $2,000 for each unit of section 8 that he can get for a client. That kind of money is unbelievable.

Senator SARBANES. What should we do about that?

Secretary PIERCE. That's just one part of it.

Senator SARBANES. What have we done about it?

Secretary PIERCE. We've cut out section 8.

Senator SARBANES. Why didn't you cut out the lawyers' fees?

[Laughter.]

Secretary PIERCE. We did cut out the lawyers' fees, because we cut out section 8.

Senator TOWER. Let me suggest that we will have order in the committee. We are delighted to have people here, but you are guests of the committee and there is a certain amount of decorum we have to preserve here.

Senator SARBANES. Mr. Chairman, I have no questions. In keeping with your time frame.

Secretary PIERCE. Mr. Chairman, I would certainly like to put in the record my accomplishments, since I was cut off in the process of answering that question.

Senator TOWER. You may submit any additional material for the record that you see fit, Mr. Secretary.

[Additional material for the record follows:]

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT ACCOMPLISHMENTS SINCE JANUARY 1981

I would like to review the accomplishments of the Department of Housing and Urban Development since I became Secretary in January 1981.

As I looked at the assisted housing picture back then, I identified two immediate challenges. The first was to assist the needy with decent, safe and sanitary housing. The second was to do so within budgetary constraints. These challenges coincided with two principles that had brought the Reagan Administration into office: providing a safety net for the poor and reducing budget deficits by cutting the size and cost of government.

In those terms, the traditional approach to assisted housing was obviously inadequate. It had obligated the Federal government to future payments of $250 billion without solving the problem of housing the needy.

Therefore, I asked the President to establish a commission on housing to develop options for a national housing policy. The recommendations of the President's Commission on Housing, the findings of our own studies and a study by the Rand Corporation coincided in key respects. We found that while there were pockets of housing shortage in some areas, there was no shortage on a national basis. Thus, the problem was not one of housing availability but housing affordability. The need, therefore, was not for new construction but for an approach that would: first, give those who qualified for assistance a wider choice in where they wanted to live and help in paying for it; and second, to upgrade substandard existing housing through rehabilitation. By using existing housing, we found we could assist approximately three times as many needy families as we could through new construction.

Therefore, I proposed the termination of expensive new construction under Section 8 except for the elderly and handicapped. Instead, we devised a system of housing vouchers, which would make use of the significant supply of rental housing in the private market.

The proposed voucher program would be scaled to individual need. Recipients of this assistance would have the flexibility not only to choose location but also the proportion of income they wish to allot to rent. Moreover, they need not live in housing projects but could rent from private landlords, who would then have an incentive to upgrade and/or maintain their units.

A second major proposal I have developed is the Rental Rehabilitation initiative. Under this proposed approach, grants would be available to rehabilitate rental units in lower-income neighborhoods. Localities would administer this program, under which substandard rental units would be "retrieved" and be available to needy families. The program is designed to encourage private investment in rehabilitation. Also, the approach would make available housing vouchers for use in connection with the rehabilitated units. In this way, more standard housing would be available to those who have received vouchers.

My emphasis upon maintaining and employing the existing housing stock also extends to the public housing stock. This stock is an important national resource, and I am committed to preserving it. I have proposed improved methods in this regard, including a new public housing operating subsidy funding system. As you know, HUD's operating subsidies for public housing have increased from $28 million in 1970 to $1.3 billion in 1983. To encourage more efficient and effective management, we propose to move from the Performance Funding System (PFS) of calculating operating subsidies according to historic costs to a system based on Fair Market Rents (FMR) in given areas. This historic cost based PFS is a system that tends to reward for poor management as well as vacant and substandard units. Under the proposed system the subsidy will be based on the amount needed to operate comparable, standard quality private housing in the locality.

The new method of funding public housing will consolidate operating subsidy and capital improvement funds into one formula. PHAs will then have flexibility and discretion in allocating resources available to them between ongoing operating and capital cost needs.

In order for the proposed system to work effectively, the Department is proposing a transition modernization which will allow PHAs the opportunity to upgrade their inventory, particularly projects that have vacant units or substandard conditions and/or are not energy efficient. The capital improvement made by the transition modernization will enable PHAs to operate efficiently within the new formula by reducing excessive operating costs, including costs attributable to high utilities.

I should note that the estimated expenditures for public housing modernization during FY 1983, coupled with the proposed transition modernization beginning in FY 1984 (and running for four years) will total about $7 billion in budget authority.

Finally, and again in regard to public housing, I have directed my staff to take steps to improve the overall management of public housing. This is occurring now. We have focused attention on the most troubled public housing agencies to help them identify the problems they face and develop the appropriate solutions. Ultimately, through both the new funding system proposals and the increased emphasis upon sound management, we have taken the steps needed to create new incentives for better management and more local flexibility.

I have made special efforts in one other area of assisted housing. This is Indian housing. The Department has proposed a new Indian Housing Program for Fiscal Year 1984 which will preserve and enhance the autonomy and flexibility of Indian Tribes. The overall program for Indians will have two major components -- the Indian Housing Program and the Indian Block Grant Program. The former introduces important improvements and flexibility to the traditional way we have funded Indian housing; the latter builds upon our Community Development Block Grant Program.

The Indian Housing Program would involve a combination of grants to write down mortgage costs and to fund water and sewer facilities, FHA mortgage insurance to induce private investment with favorable terms and provisions for use by Indians, and for very low income Indian families, the Housing Payments Certificate Program tied to the new units for a 15 year term. A total of $76 million in budget authority would be authorized to facilitate the construction of 1,500 homes for families needing housing assistance in Indian areas.

I would like to note that while we have steadily cut back HUD's costs, we have actually been assisting an increasing number of families. In 1980, 3.26 million units were assisted, but in 1981, 3.29 million units received assistance. The comparable figure for 1982 was about 3.5 million and for 1983 we project around 3.7 million. This figure will grow to over 4 million by 1985 through incremental units being added by our proposals and through effective management of the "pipeline." I would stress in this regard that our efforts to bring assisted housing on line represent a strong commitment to housing the poor. We found a number of projects stuck in the pipeline because high interest rates made financing infeasible. By initiating techniques such as the Financial Adjustment Factor, we made many projects feasible and thus will be able to make them available to lower-income families.

An additional responsibility of HUD is the administration of the Fair Housing Law. Since becoming Secretary I have made it clear -- in speeches, posters, informational and educational programs -- that I am dedicated to the principle of equal access for all Americans to housing opportunities. However, the Fair Housing Law (Title VIII of the Civil Rights Act) has been consistently criticized as not having sufficient enforcement mechanisms. Right now an "aggrieved party" can come to HUD for an investigation and an attempt at conciliation. However, if our conciliation efforts fail, the person asserting discrimination must file suit himself or herself. This often is no remedy at all, given the cost and time that would have elapsed.

Therefore, I am working on a legislative proposal that would authorize the Secretary to file a suit seeking a civil penalty if conciliation efforts fail. This would be done, of course, where the investigation supports discrimination charges.

Generally speaking, since I became Secretary of HUD I have increasingly focused our efforts on helping lower and moderate income Americans realize the dream of homeownership. I came to the conclusion early in my tenure that the FHA was an indispensable mechanism for realizing this objective. We are emphasizing FHA's traditional role in the marketplace -- that of serving first-time homebuyers, insuring rural and inner-city properties, and acting as an innovator in the mortgage finance sector. To this end I have proposed that down payments on mortgages under $50,000 be reduced to 3%. We do not intend to compete with private insurers; rather, we will target our FHA activities to those who are unserved or underserved in the market.

In the administration of the FHA program I have been able to bring these rates down from 17-1/2% in August, 1981 to a current rate of 12%. (This reflects the success of the President's recovery program in bringing down the rate of inflation as well as overall interest rates.) The significance of this decline lies in the fact that for every drop of 1/2 of one percent in the interest rate, an estimated 800,000 more homebuyers come into the market. Thus during the past year-and-a-half, about nine million more American families have been positioned to purchase their own homes.

In fact, our experience is demonstrating the accuracy of these projections. In the past few months, record highs have been established in new housing starts and the rate of applications for FHA mortgage insurance.

At the same time, through FHA and GNMA, we have been encouraging the introduction and use of innovative mortgage instruments to help the homebuyer. These new instruments reflect the need for mortgage instruments other than the standard 25 or 30 year fixed payment mortgage. The following instruments illustrate this thrust:

- Shared Equity Mortgages, by means of which investors share the mortgage payment in return for a share of the equity of the home at the time of sale and the tax benefits.
- Graduated Payment Mortgages, which allow payments to increase as the homeowner's income increases. These can now be coupled with builder buy-down arrangements. I have proposed extending this program to multifamily projects.
- Growing Equity Mortgages, under which increasing payments result in earlier payoff of the mortgage, allowing a lower, initial mortgage rate.

I also have proposed to the Congress that FHA be authorized to insure other types of mortgage instruments:

- Adjustable Rate Mortgages (ARMS), limited to 125,000 a year, which provide for annual adjustments in the mortgage contract rate of up to 1 percent yearly, with a 5 percent cap on increases overall;
- Shared Appreciation Mortgages (SAMs), limited to 50,000 single family homes a year, as well as multifamily units which permit lenders to share in out-year appreciation in return for a reduced mortgage interest rate; and

-- A Home Equity Conversion Demonstration Program, limited to 1,000 mortgages, to help "house rich, cash poor" elderly homeowners to convert their home equity into supplemental income and/or to meet major housing and other expenses. Types of mortgages to be insured include Reverse Mortgages (RMs) and Reverse Annuity Mortgages (RAMs).

Through these efforts, mortgage credit will be more affordable and available to homebuyers. I should note, also, that I have proposed moving FHA to a system of negotiated interest rates, to bring us in line with the financial market.

HUD is also instituting direct endorsement of FHA-insured loans as a better way of serving the "FHA market", i.e., primarily first-time and low- to moderate-income urban homebuyers. Direct endorsement, which is scheduled to begin in early May, is one way of improving FHA's program efficiency. Under this procedure, lenders will process applications for FHA insurance, and HUD will conduct checks, on a post-audit basis, to assure underwriting quality. This new approach is part of the Administration's broad effort to transfer governmental functions to the private sector wherever appropriate and possible.

In addition, we have taken a number of initiatives which are not only promising in themselves but which cost the government very little money. One such program is our Joint Venture for Affordable Housing and another involves pension funds.

The primary objective of the Joint Venture for Affordable Housing is to reduce the cost of housing through deregulation and by streamlining processing procedures. To that end, HUD is working in partnership with State and local authorities -- and with the housing industry -- to modify codes at the local level.

We are currently conducting demonstration projects for the Joint Venture in approximately 30 communities around the country. Results to date indicate that as much as 20% has been saved -- and passed on to the buyer -- under this program. This, coupled with the reduction in interest rates we have seen, results in substantial savings to purchasers of housing. For example, if a family which had received a $10,000 savings on a $50,000 home in the Joint Venture Demonstration combined this reduction with the recent interest savings, their home could be purchased for approximately $105,920 less over the 30-year life of their loan. This translates into a monthly savings of $322 or a 44% reduction in their monthly mortgage payment.

As for our pension fund initiative, our objective is to increase the amount of money available for mortgages by tapping into the enormous resources of the pension funds. It is estimated that these funds represent about $700 billion and that only a small fraction, in the area of 3%, are invested in mortgages and mortgage-related instruments.

We found two reasons for this deficiency. First, ERISA inhibits certain types of pension funds from investing in mortgages. Therefore, we have been working with the Department of Labor to modify some of the ERISA restrictions. Secondly, most pension fund managers seem unfamiliar with the advantages, from an investor's point of view, of mortgages and mortgage-backed instruments. Therefore, I have been conducting a series of meetings with the managers of the largest pension funds in order to acquaint them with features of the mortgage market that make it very attractive to investors.

Turning now to the urban development responsibilities of HUD, after studying our relevant programs I focused on Urban Development Action Grants (UDAG's) as a program worthy of support by this Administration. Others in the Administration thought UDAG's should be phased out. However, studies by our Policy Development and Research Office showed that UDAG's were extremely effective in attracting private investment into economically distressed areas. In fact, it was estimated that for every dollar of UDAG money, the private sector was investing about six dollars. Moreover, these investments were creating job opportunities right in the distressed areas where unemployment was high. Therefore, I presented the case in favor of UDAG's to the President, and he concurred. Our experience with UDAG's continues to be very favorable and, I believe, justifies my defense of this program.

I have also fought for the maintenance of HUD's Community Development Block Grant (CDBG) program. Under our administration of CDBG's, these grants permit considerable flexibility and decision-making at the local level. This flexibility is fully consistent with the President's New Federalism initiative.

I had occasion recently to make another defense of our CDBG program. When Congress passed the Jobs Bill in March 1983, it included one billion dollars for job-creating projects through the CDBG program. This allocation was interpreted by some as an advance on the amount budgeted for CDBG's in fiscal year 1984, and there was an effort to reduce by that amount CDBG funds included in the proposed budget for fiscal year 1984. However, I opposed this interpretation and as a result the billion dollars for CDBG in the Jobs Bill will not be deducted from the proposed CDBG funds budgeted for fiscal year 1984.

HUD has also been a leading Federal agency in the development of Enterprise Zone legislation. The aim of the Enterprise Zone concept is to revitalize economically depressed areas by attracting business into them and thus create jobs. The last session of Congress did not have time to act on this proposed legislation, but the President has resubmitted it to the present Congress, and I have high hopes not only that it will become law, but that it will prove an economic stimulant to many depressed areas in our country.

I would like to conclude this statement with some notes on our achievements in the internal management of HUD since I became Secretary.

When I took office, no one could tell me how much was owed the Department in delinquent debts. To get an answer, I set up a task force and we identified a delinquent debt of $1.6 billion. At the then-prevalent prime rate of 15-3/4%, that delinquency was costing the American taxpayers $252 million a year.

I quickly ordered a more aggressive debt collection program, including taking people to court if they did not repay their HUD loans. David Stockman, Director of OMB, wrote to me at the time, saying, "You are the first Cabinet member to announce such a positive change in debt collection policy, and I wanted you to know we're grateful to you for taking the lead."

That policy is paying off. In one loan program alone, we have reduced the delinquency rate from 25% of the outstanding loans to about 6%.

In other areas, we have effected significant economies in the administration of HUD. When I took office HUD had 15,500 employees. By February 1983 the number of employees had dropped to 13,412, largely through attrition. If Congress accepts our proposals for fiscal year 1984, we expect that HUD employees will number 11,791 by the end of September 1984. That will represent a decline in staff of fully 24% since I became Secretary.

At the same time, we are projecting $40 million in savings annually through improved accounting procedures. We have saved another $25 million through economies in telephone, space, travel and publication costs. Tighter scheduling of payments, together with electronic transfer of funds to public housing authorities, will save $1.6 million in interest per year. An additional $1 million per year is being saved through a program for a bank lock-box. Under this arrangement, people can make their mortgage insurance premium payments to a post office box to which the bank has access. The bank can them immediately credit HUD's account. In that way, two to three days are saved, and that much more interest accrues to HUD's account.

We have also cut back on the printing costs of regulations. In fiscal year 1980, HUD published 2,155 pages of regulations, which were reduced to 945 pages by fiscal year 1981. By fiscal year 1982, we had brought this number down further to 528 pages. The savings in printing costs over those two years was one-half million dollars -- from more than $750,000 to less than $216,000.

Through a combination of such management efficiencies and the kind of creative initiatives outlined in this statement, we are shaping HUD into an agency for more effectively meeting the housing and urban development needs of the American people. As Secretary of HUD I am proud of the Department's achievements during my tenure.

Senator **Tower**. Mr. Secretary, thank you for coming today. It's been a very useful and spirited hearing. This afternoon at 2:15 we will hear from our panel. The hearing is recessed until 2:15 this afternoon.

[Whereupon, at 12:30 p.m., the hearing was recessed, to reconvene at 2:15 p.m. this same day.]

AFTERNOON SESSION

Senator **Tower**. This afternoon we have testimony by a panel on the cost of housing, which, it occurs to me, is an enormously important topic. I think that this would be a very useful hearing this afternoon.

I want to first apologize to the panel for the fact that we did not have the opportunity to bring you on at the scheduled time this morning. But, as you could see, there was somewhat more than casual interest in what the Secretary had to say. And therefore, we had to carry over to this afternoon.

Our panel consists of Will Ehrle, the president of the Texas Manufactured Housing Association; Donald J. Hogan, representing the American Institute of Architects; Robert M. Dillon, vice president of the National Institute of Building Sciences; and Robert A. Georgine, president of the Building and Construction Trades Department of the AFL-CIO.

Mr. Georgine apparently has been detained, but we will seat him at the table as soon as he arrives. He's an important participant in this panel.

But I think in the interest of time that perhaps we had better proceed with the panelists that are currently seated at the table.

Gentlemen, you may submit statements of any length that you choose for the record and they will be spread upon the record. You may summarize your statements if you like. We prefer that if you do have long statements, that you summarize them, so that we can give over more time to questions.

Before I recognize the panel, let me yield to the distinguished Senator from Michigan, Mr. Riegle, for any opening comment that he may have.

Senator RIEGLE. Thank you, Mr. Chairman. I have no comment at this time. I am delighted that these witnesses are here, and I am interested in hearing from them.

Senator TOWER. Well, gentlemen, we will proceed simply in the order that you are listed on my sheet here, which is not even alphabetical, which, viewing the youth of all of you, has nothing to do with seniority. But we'll just start with Mr. Ehrle and then recognize Mr. Hogan and then Mr. Dillon, if that's agreeable, unless you have some precaucused arrangement on which order you'll speak.

Mr. Ehrle.

STATEMENTS OF WILL EHRLE, PRESIDENT, TEXAS MANUFACTURED HOUSING ASSOCIATION; DONALD J. HOGAN, REPRESENTING THE AMERICAN INSTITUTE OF ARCHITECTS; ROBERT M. DILLON, VICE PRESIDENT, NATIONAL INSTITUTE OF BUILDING SCIENCES; ROBERT A. GEORGINE, PRESIDENT, BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

Mr. EHRLE. Thank you very much, Senator. My name is Will Ehrle and I reside in Austin, Texas. I am appearing before the subcommittee today on behalf of the National Manufactured Housing Federation, of which the Texas Association is a member.

The National Federation is composed of 41 State and regional trade associations representing over 30,000 businesses in this country. These businesses cover the entire spectrum and range of the manufactured housing industry. For example, I represent in the Texas association, not only retailers, but manufacturers, suppliers of goods and products and materials, insurers of homes and mortgage bankers and lending institutions.

The National Federation, being composed of the State organizations, is the only trade association in this industry that speaks for a broad cross-section of the entire industry. The Manufactured Housing Institute, of course in Washington, represents the manufacturers of homes only. So we have duplicate members in that one category.

I'll try to summarize my statement, even though it's not too lengthy, Mr. Chairman, and hopefully, the summary will be shorter than having read the statement.

Texas, by the way, Mr. Chairman, is the leading State in both the production and in the sale of manufactured homes. For example, in 1981, 36 percent of all new single-family residences in Texas were manufactured homes. In 1982, the sales figures are all in for manufactured housing and 41,263 new single-family residences were sold in the State of Texas, manufactured single-family residences.

We estimate that when the final figures are in for site-delivered—I mean site-assembled—site-built housing, that this will represent approximately 38 percent of the entire single-family market.

So manufactured housing across the country has become a major source of housing, particularly in the single-family residential area. And it's our projection that within 3 to 5 years you'll find that manufactured homes constructed in a plant facility somewhere off of the home site, delivered to the home site, and then installed on a foundation system at the home site will comprise over 50 percent of the single-family residential market.

Just as an aside, Mr. Chairman, and not in the statement, let me also say that, for example, two of the most recent members of the Texas Manufactured Housing Association are two of the Nation's largest home builders—U.S. Homes, headquartered in Houston, and Fox & Jacobs, headquartered in Dallas, are both now members of the Texas Manufactured Housing Association, because they are substantially involved, or beginning to be substantially involved in the manufactured housing business and the construction of modular homes.

We're talking today, of course, about costs, Mr. Chairman, and costs are an extremely critical factor with reference to housing. We must have available housing, but that housing is not really available. And the fact that our housing inventory might consist of certain numbers of homes, rental units, and so forth is really not significant, unless that housing is affordable to the vast majority of the American people.

Now, of course, the concern of the committee has to be with regard to the public health, safety, and welfare of the constituents of the various members of the committee. We understand that and that aspect of the public interest, we agree, should be paramount in your consideration.

Now with the current emphasis on deregulation, on streamlining, and modernization of housing programs, we believe that manufactured housing offers an ideal portion of the ultimate solution for streamlining of some of these processes. We think that through manufactured housing, that a large part of the housing needs of the country can be satisfied, at least substantially, substantially, without huge, massive, new, direct subsidy programs and without unreasonable outlays of federal funds.

CONSTRAINTS IMPOSED ON MANUFACTURED HOUSING

There are a number of constraints that are currently imposed on manufactured housing because of the history of the industry, because of the old trailer house image from which the manufactured housing industry grew, out of which it grew.

So, basically, today we're going to be asking for something from the committee and that is equality through parity. Not something special, but simply equal treatment under the law with reference to kind and type of homes that are being constructed in factories and in plants.

Now with reference to cost and state of the art for manufactured housing, we have some charts and exhibits to show you. And, by the way, the testimony is divided into two pieces, although they have the same back. The one with the staples on the outside are the exhibits, so that you can look at the exhibits along with the testimony, rather than having to flip back and forth.

But housing costs are increasing and as we take a look at the exhibit 1, as you well know, and it's redundant almost to point out to you, that the annual housing expenses for new median-priced single-family homes has risen in the past 10 years. And this chart is only through 1978—substantially faster than the median-family income.

SITE-ASSEMBLED VERSUS SITE-BUILT HOME COSTS

It simply means that far fewer families can afford housing today that could afford homes 10 years ago. Manufactured housing offers homes, however, even in 1983, from a range of $12,000 to $60,000. Let's look at some of the costs on exhibit 2, relative costs of site-assembled or site-built homes and manufactured homes.

And I'm not sure if you'll be able to read the footnotes there, but perhaps on the charts you can. Manufactured homes, for example, in 1981—and these are 81 figures—the average sale price of manufactured housing or homes was $19,900. Now that included furnishings, but did not include land, nor installation. The average price for a site-built home was $83,000. Now that did not include, of course, any furnishings, but does include land.

Let's look, though, at the cost per-square-foot because I think that that is a comparison that is needed and is far more meaningful to the committee.

The cost per-square-foot for a manufactured home was $19.13, based on these figures, and that for a site-built home of $39.06.

Now let me hasten to add that it's not on this chart, but in all fairness, I want to make sure that we're comparing apples to apples. This average price for a manufactured home does not include some of the foundation costs and the delivery costs to the home site. Obviously, a site-built home is built onsite, so there are not those expenses. But let's add an average, and this would be a good figure, of $2,000 on an average for a manufactured home to be delivered to the site and installed on a foundation system.

So if you add that $2,000 to the $19,900, to get really a true comparison, then you'll have an average square-foot cost of $20.09 and, of course, a $21,900 average cost.

Senator TOWER. Is that $2,000 just the foundation cost? That does not include the cost of the land.

Mr. EHRLE. That is correct, sir. Now remember the square footage prices, though, that we're comparing does not include the cost of land for a site-built home, either.

Senator TOWER. Fine.

Mr. EHRLE. In chart No. 3——

Senator TOWER. Mr. Ehrle.

Mr. EHRLE. Yes, sir.

Senator TOWER. At this point, would you suspend? All of those bells that you heard are an indication that we have a record vote on the floor. And Senator Riegle and I now have approximately 6 minutes to get there. He is more fleet of foot than I am, so I'm going to recess us now for about 10 minutes to go vote and return.

Mr. EHRLE. Fine. Yes, sir.

[Brief recess.]

Senator TOWER. The committee will come to order.

Mr. Ehrle, I apologize for the interruption. Will you resume?

Mr. EHRLE. That's perfectly all right, Senator. You're like the cowboy looking at the hot horse show. It don't take you long to vote, does it?

Senator TOWER. Not long. If I know what I'm voting on.

Mr. EHRLE. We were looking at some cost comparison figures on a square footage basis, Mr. Chairman, before the recess; $20.09, basically, against a $39 figure for site-built construction. Now let me also add that the manufactured home that costs $20.09 does not have a two-car garage. It does not have a basement.

So when we're talking about averages across the country, we're talking about homes that would not be as large and would not have, perhaps, some of the amenities. But we're also talking about homes that are code-constructed and are of comparable code quality.

In chart 3, there is simply a listing, and we won't go through them, in the interest of time, of the percentage of total costs of a manufactured home for the various types and kinds of components.

And then in chart 4 we have a listing which shows the component costs of manufactured housing. Materials costs, for example, 71 percent. Direct and indirect labor, 14 percent and 2 percent. Plant overhead, profit, and so forth and so on.

Basically, of course, manufactured housing is not an intense labor cost form of housing. However, it does require, of course, substantial numbers of workers in the various plants.

As we look at chart 5——

Senator TOWER. Do you have some of the same skills that would be hired on the onsite construction?

Mr. EHRLE. Yes, sir. Yes, sir. The one major difference would be, for example, Senator, there are quality control engineers, as required by HUD and required by the agreement between NCS, BCS, and HUD for the monitoring of the code construction program.

So you might not have a master plumber or a master electrician in the factory because HUD has supplanted that, in a sense, with the control control engineers from the standpoint of training, background, and education for assurance of safety, as opposed to an independent contractor out on a site without any quality control engineering supervision.

But yes, sir, the same things are done, except they're done inside the plant.

Chart 5 in exhibit 3, excluding land and installation costs, we simply show what the average price was for single section and multisection manufactured homes in 1981, $16,500, $26,800. Now those prices, as I say, do not include land or installation costs. If you put one of the homes on a rather inexpensive lot, and you can add $2,000 for delivery and installation cost, then you have a very inexpensive form of house.

Although those are 1981 figures, Senator, even today, in 1983, we can construct in our industry a manufactured home to the HUD construction code and sell that home for as little as $12,000. Now that's a safe home. It's a decent home. And it's affordable by a tremendous number of American families.

Now it's not the ideal home that we would all like to have. It's, of course, not a two-story southern colonial. It's not a traditional New England manor with acreage and so forth. But it is housing that is affordable for the vast majority of the people.

Chart 6, we simply have some additional comparisons with regard to sales and shipments of manufactured housing, and all that really does is demonstrate what I had said a little bit earlier in that manufactured housing is a major source of housing today.

Now in chart No. 7, exhibit No. 4, which we have, we have listed some reasons why factory-produced homes cost less. And I want to stress, No. 1, a preemptive Federal code. Because of the interstate and intercity aspect of constructing components in plants and assembling them perhaps in another plant and then delivering the finished product, it's simply not possible to operate based on divergent local and municipal codes.

For example, in Texas, there probably are over 200 variations of just the standard, the old southern building code. There are also numerous variations of the uniform building code.

Now the point here is simply that a preemptive Federal code is critical because the manufacturers can build to a single code and they can construct a home to that one code. So that it makes the assembly line process function. It makes the cost effectiveness of the home realistic, from the construction standpoint.

Many of our manufacturers have differences as to what the code ought to be. But we try to work with the code groups. And, by the way, I've got to compliment the CABO group for trying to bring the recognized code groups together and in emphasizing the one- and two-family dwelling code.

Again, a national code would be very helpful even to site-built homebuilders. In the manufactured housing industry, it's critical to have a single code.

Volume purchasing of materials, system-engineered production lines, tight quality control, less labor-intensity, no weather interruptions, shorter production time. Savings in pilferage is a big item because building onsite, you lose a good bit of materials from simply pilferage and vandalism.

And, of course, there's a savings in interim financing costs.

I think we can demonstrate that manufactured housing is affordable. I think we can demonstrate that more intensive and greater use of manufactured housing from a competitive standpoint will assist in perhaps not bringing housing costs down, but in holding housing costs from continuing to rise and escalate quite so rapidly.

But one of the problems that we have in the manufactured housing industry, and beginning on page 7 of the printed statement, we have barriers to the affordability and constraints against manufactured housing.

RESTRICTIVE ZONING PROBLEMS

We have exclusionary zoning situations where some cities, simply by ordinance say, you cannot place a manufactured home in this city. Then along with the homebuilders, we share restrictive zoning problems. One of the problems, when you talk in terms of creating jobs from a standpoint of housing assistance programs, is zoning. For example, you can allocate the money today and Secretary Pierce could put it in the pipeline today. But in some municipalities across this country, it might take 6 months to 3 years before you could achieve the necessary zoning variances to even begin to get your permits and begin construction, whether it's manufactured housing or housing built on site.

LIMITED SECONDARY MARKET FINANCING

There has been, of course, limited secondary market financing for manufactured homes. Now there is very little that the Congress could do about that. We, as an industry, continue to work on that particular problem. One thing that could be of assistance would be if statutory authorization could be given in the 1983 housing bill to the Federal Home Loan Bank Board for the implementation, as it might desire and within the regulations that might be implemented, a secondary market for manufactured homes only. That's without land.

Now, again, the reason that this is important, Mr. Chairman, is simply because we have made situations all across the country where the parents or the grandparents have land and have a place to put a home. But they're not willing at this moment to subdivide that particular tract to their children or grandchildren. But they do have a spot where they could put a home. So if this financing in the secondary market were available for a home only, with appropriate landlords' waivers and things of that nature in order to protect the mortgage on the house itself, this would be a substantial help in providing availability of housing for the public.

In a separate folder, a little blue folder that I hope you got and we had enough for each member of the subcommittee, there is a little article about zoning from the standpoint of the Houston Homebuilders Association group, Mr. Chairman.

Also in there are a series of six pictures. I put those in there so that you could look at them and try to determine which of these six are manufactured homes and which are site-built homes. I won't embarrass you by giving you the test, simply because a Senator could not afford to make a mistake on missing one. But I will tell you which are which at the conclusion of my testimony.

Manufactured housing problems, manufactured housing concerns are something that has been bipartisan. Both the present administration and the past administration had commissions that were designated to study housing and affordability of housing. The report on the Council for Development Choices for President Carter recommended some changes to promote the inclusion of manufactured homes in cities and the further use of manufactured housing. President Reagan's Commission on Housing did the same thing.

So we simply think that there has been a demonstrated need on a bipartisan basis for additional manufactured housing. I've listed a couple of things on page 10 that the Congress might be able to do.

And, in conclusion, let me simply mention the fifth item that we put in the list of constraints, and that's the single standard, the HUD code standard, nonessential HUD standard requirements.

Now, Mr. Chairman, we don't mean that requirements and code standards that are in the public interest from the standpoint of health and safety are not critical, and they must be there. However, we do believe that the interests, the public interests, have to be balanced. There is, of course, a substantial public interest in the affordability of housing. There's also a substantial public interest in safe housing, in housing that is as highly resistant to fires as possible.

And as I point out in the statement, of course, we can build—we can build a home that will never burn. But no one, or at least very few people, would be able to afford it. So the balancing of the code interests and the affordability have to be determined. And I suspect that that determination, unfortunately, will ultimately fall on the Congress because of the competing interests of the various groups in these items.

And, in closing, Mr. Chairman, I simply say in my statement, lay out a challenge to the committee—if at least some portion, and I'm not talking about a major portion—but if some portion of the public housing assistance funds and the community block grant funds could be earmarked for manufactured housing projects, I'm simply going to say to you, without any question, that our industry can deliver 30 to 40 percent more housing per Federal assistance dollar than any other form of housing that has been obtaining these Federal assistance dollars today.

And I'm confident that my figures are correct and I'm confident that they would fall within that range.

With your help in eliminating some of the constraints and some of the restrictions on manufactured housing, we think that we could add 50 percent to the available housing that will be so desperately needed during the next 10 years.

I sincerely appreciate the opportunity, Mr. Chairman, to appear and to be present. And if you'd like to look at any of the pictures, let me simply tell you that they are all manufactured homes. These are even mobile homes, in the sense that they are derivatives of the mobile home. These are HUD code-constructed homes. And I have some price figures that might be interesting to you and let me point out where some of them are from.

On the back you'll find a little number. No. 1 is a home that's in a subdivision in New Braunfels, Tex., and the total price of this home, the land and the foundation system and everything you see in the picture, was $39,000.

Senator **Tower**. When?

Mr. **Ehrle**. Two years ago.

Senator **Tower**. 1981.

Mr. **Ehrle**. Yes, sir. Picture No. 2 is a picture of a California model home. This was a demonstration home that was set up by a manufacturer and is not actually on a subdivision site. This home would retail for approximately $45,000. So depending on the price, then you add to that your delivery and so forth. You'd have $49,000, perhaps, for this home and then plus the cost of your developed lot in California.

Picture No. 3, this particular picture is picture of a manufactured home with 1,760 square feet in it that's in a subdivision in Cleburne, Tex. It was sold in 1982, early 1982, for a price of $42,500.

Picture No. 4, I must confess, Mr. Chairman, I know the house and I know the manufacturer. I do not know where this particular home is located. But let me give you the retail figures for it because it is constructed with the two-car garage addition as a module that is built with the home and can be attached. This particular home retails for around $39,000 to $40,000.

So for about $42,000, it could be installed on your lot or your site, or plus the cost of the developed lot.

Picture No. 5 is a home in New Braunfels. It's about 2½ years old. It was sold for $37,500. It's in the same subdivision as picture No. 1.

Picture No. 6 is a manufactured home with brick veneer, you will see, priced at $59,000. But it's on a half-acre lot. This home was sold about 3 years ago in the State of Washington.

Manufactured housing is a viable source of affordable housing for American families. And the manufactured homes that we're selling today simply are not the trailer houses of yesteryear. I wrote a song recently along with a colleague of mine, Mr. Chairman. We haven't been able to get it published yet. But it's called, "Ain't No Trailer Trash Gonna Live Here."

We submit to you that the industry we represent today is far different from that industry of the 1940's and early 1950's, when the homes that were being constructed were temporary. These are permanent homes, placed on a permanent foundation, in many instances.

We simply ask for equality and would hope that you would give us a chance to help lower the costs or keep the costs of housing as low as possible.

Thank you, sir.

[Complete presentation of Mr. Ehrle follows:]

United States Senate
Committee on Banking, Housing and Urban Affairs

BEFORE THE

Housing and Urban Affairs Subcommittee

Honorable JOHN TOWER, Chairman

TESTIMONY OF WILLIAM L. EHRLE, SR.

Representing the

NATIONAL MANUFACTURED HOUSING FEDERATION

March 8, 1983

Chairman Tower and Members of the Banking Committee:

My name is Will Ehrle; I reside in Austin, Texas; and I appear before the Subcommittee today to present testimony on behalf of the National Manufactured Housing Federation.

The National Manufactured Housing Federation (NMHF) is a non-profit trade association whose membership consists, as of this date, of 41 state and regional manufactured housing trade associations. These state and regional associations are comprised of an aggregate of approximately 30,000 member business firms which are engaged in the retail sale of manufactured homes and in the development and operation of manufactured housing communities across the country. In addition, a number of the state associations represent members engaged in the manufacturing of homes. Thus, the National Manufactured Housing Federation is the only organization at the national level which speaks for a large and broad cross-section of the manufactured housing industry.

By way of additional background, while I speak today as a representative of NMHF, I am President and General Counsel of the Texas Manufactured Housing Association. In this capacity I represent all segments of the manufactured housing industry: manufacturers, retailers, park and community owners and operators, mortgage bankers, and financial institutions engaged in financing the purchase of manufactured homes, insurors of homes and suppliers of various goods and services to the manufactured housing industry.

Texas is the leading state in both the production and sale of manufactured housing, and this site-delivered housing is a vital part of the housing market in my home state—as it is across the United States. It has become virtually the only source of new single-family homes which cost less than $40,000.00, and manufactured housing provided more than one out of every three (36%) new single family homes built in the United States in 1981. In Texas, Mr. Chairman, 41,263 single-family manufactured homes were sold in 1982 and we believe that this will represent 38% of that shelter market when the final sales figures are in for site-assembled housing for last year.

We project that in the next three to five years factory-built, site-delivered homes (both mobile/manufactured and modular homes) will account for over fifty percent (50%) of all new single family residences which are annually constructed in this country.

Thus, Mr. Chairman and Members of the Committee, in your deliberations and consideration of the issues and questions which develop as a result of this hearing—please remember that any action which you may take regarding manufactured housing will affect the availability of affordable housing for millions of American families in the future. The public interest in the availability of affordable housing should be a predominant factor in your consideration. A lack of such availability is beginning to reach the crisis stage in virtually all sections of this nation. The health, safety and welfare of your constituents is (as it should be) your major concern, and the availability (or lack thereof) of well constructed, energy efficient housing at an affordable price is impacting the health, safety and welfare of a tremendous number of your constituents. This aspect of the public interest must be ever present as you consider the need, if any, for legislation.

With the current administration's emphasis on the elimination of unnecessary federal programs, on balanced budgets, and on tax revision, a legitimate question is raised as to what extent, if any at all, the federal government should be involved in housing programs. We believe that there is a vital role which the federal programs should play in housing assistance. Yet, we also believe that government housing programs should be reexamined, streamlined, and revitalized in order to assist the housing industry to meet the needs of the public through the free enterprise system. We believe this can be done in large part without new kinds of massive direct subsidy programs and unreasonable outlays of federal funds. A substantial part of the answer to, and the solution of, our housing needs and problems could cost little money and less funds in direct subsidies. It could be achieved by merely removing long standing constraints against factory constructed homes. Constraint-removal carries no price tag and rests solely on the principle of "equality through parity". That is, homes of comparable size and quality should enjoy equal treatment in government programs and policies. Since the manufactured home is now, and has been since 1976, the only residential dwelling built to a mandatory federal construction code, the old "trailer house" issues concerning its quality or safety are simply not relevant. The advocacy of constraint-removal to achieve parity requires only recognition of the industry's current "state of the art" and an application of its capability to produce and market homes in single or multi-sections in a variety of sizes, models, designs and prices from a range of $12,000 to $60,000. It is, thus, no longer useful or realistic to base housing programs or policies on outdated concepts, or technical or on esthetic perceptions which suggest differences between comparable factory constructed and non-factory constructed residential dwellings. In simplest terms, we submit that "comparable housing should be treated comparably".

The Federation is appreciative of this Committee's inquiry into the matter of housing affordability. We point out that of the various alternatives open to government policy markers, the manufactured home offers unique advantages in assuring a rapid, feasible and desirable solution to the fearsome national housing problem depicted on Chart One. (Exhibit #1) This Census Bureau information tells us that increases in annual housing expenses for a new median-priced single-family home are rising far more rapidly than median family income. In short, lack of affordability is pricing the family of modest income out of the housing market—that is to say—the site-assembled housing market.

In this connection, it is interesting to note on Chart Two (Exhibit #2), of the relative costs of site-assembled and manufactured homes that the more meaningful statistic in this chart is expressed in "cost per square feet", since these comparisons both exclude land costs. However, Mr. Chairman, it should also be noted that the average price and square footage price for manufactured homes does not include the delivery and foundation installation costs. The site-built home figures do include such costs. However, even after adding $2,000 for these additional costs, the average sale price would be $21,900 and the average price per square foot only $20.09.

A closer look at the low-cost factory-constructed home provides some insight into its component costs. We see some approximate component cost percentages expressed in table form in Chart Three. We would point out, here, that the performance specifications for all of these components are mandated by the federal construction standards administered by the Department of Housing and Urban Development in accordance with legislation enacted by the Congress in 1974.

Expressed in a different way, our Chart Four reflects the percentage of total production cost incurred by cost element. One clue to the factory-constructed home's affordability can be noted in the fact that about 70% of the costs are for materials.

Having considered, then, manufacturing costs in terms of components and elements, we can begin to appreciate the resulting affordable retail prices shown in this Chart Five (Exhibit # 3). Although our latest data reflects 1981 costs, we emphasize to this Committee that it is still posible, in 1983, to buy a fully-furnished manufactured home, constructed to the HUD federal standard, for around $12,000. That, we submit, is "affordable housing."

Apparently, the American home buyers agree. Chart Six tells us that of all the new single family homes sold in 1981, 36% were manufactured homes, an all-time high percentage. In the below-$40,000 price range, the manufactured homes' 89% share of the market is even more striking.

In this Chart Seven (Exhibit # 4) we have endeavored to anticipate the inevitable question of "why the manufactured home is so much more affordable." We suggest these nine listed reasons and have listed the existence of a preemptive federal construction mode as "number one." Within current de-regulatory philosophy, it may indeed apear somewhat bizarre to advance the proposition that "regulation enhances affordability." Yet the reason is simple enough, and relates to the unique capability of this industry to achieve economies of scale from its standardized and scientifically designed production system *only* if it is concurrently possible to build such homes in accordance with *one* standard that preempts *all* local standards. Indeed, this industry could not long survive as the nation's best hope for affordable housing, if manufacturing plants had to custom build each home to the special requirements of the local government having jurisdiction of the home's ultimate location. We mention this Mr. Chairman, since we have noted an anouncement this month by the National Institute of Building Sciences that the Department of Housing and Urban Development is now drafting contractual arrangements for a private, voluntary code group, to assume HUD's present code-making function. It is vital to affordable housing that this preemptive feature be retained.

Having considered the inherent cost advantages of the manufactured home, we have suggested a number of major barriers to affordability.

BARRIERS TO AFFORDABILITY

(CONSTRAINTS ON MANUFACTURED HOUSING)

1. EXCLUSIONARY ZONING
2. RESTRICTIVE ZONING
3. LIMITED SECONDARY MARKET FINANCING
4. EXCLUSION FROM FARMERS HOME ADMINISTRATION RURAL HOUSING PROGRAMS
5. NON-ESSENTIAL HUD TITLE VI STANDARD REQUIREMENTS

At first glance it may seem that items one and two of these "barriers" are redundant, yet, both are current practices and unfortunately are wide-spread throughout the nation. Both are severe deterrents to affordability. "Exclusionary" zoning is accomplished by means of ordinances which simply exclude manufactured homes from districts zoned for residential use, and which confine them solely to rental parks. "Restrictive" zoning, though sounding less harsh, prevents the installation of manufactured homes in residential districts in more subtle ways —that is, by mandating certain aesthetic characteristics not required of site-constructed homes, or establishing MH zones in industrial or completely non-desirable residential areas. As an example my home town of Austin proudly proclaims that it does not discriminate against manufactured housing, that it has established an MH subdivision ordinance. However, since the ordinance was adopted in 1973, not one single MH subdivision zoning request has been approved. Both practices have the effect of reducing the supply of affordable housing in the market place. The industry's position in this matter is to accept the common sense principle of preventing the random mixing of non-harmonious or incompatible housing forms in residential districts. We do suggest that exclusion or restriction of residences simply because they are factory-constructed is not in the public interest and a barrier to affordability. At this time I would appreciate having the Chairman's permission to distribute to the Chairman and members of the Committee some photographs of homes from several subdivisions in several states. I will refer to them in a few moments. The recognition that such archaic zoning policies is a national disgrace is widely shared at the federal level. We have extracted a quotation from the Report to President Carter from the "Council on Development choices for the '80's". It clearly condemns discrimination against manufactured housing.

THE REPORT OF THE COUNCIL ON
DEVELOPMENT CHOICES FOR THE '80s

> "ANOTHER WAY TO PRODUCE MORE AFFORDABLE HOUSING IS TO ALLOW GREATER USE OF MANUFACTURED HOUSING."
>
> . . .
>
> "HOUSING COMING OFF ASSEMBLY LINES COMPARES FAVORABLY IN LOOKS, LIVABILITY, AND DURABILITY WITH CONVENTIONAL HOUSING. WHEN THESE UNITS ARE SENSITIVELY SITED AND LANDSCAPED, LITTLE BUT PRICE DISTINGUISHES THEM FROM OTHER HOUSING. ALMOST ALL LOCAL AND STATE REGULATIONS, HOWEVER, DISCRIMINATE AGAINST MANUFACTURED HOUSING. THESE DISCRIMINTORY POLICIES CAUSE COMMUNITIES TO IGNORE AND FORGO A PROMISING OPPORTUNITY TO NARROW THE GAP BETWEEN THE SUPPLY AND DEMAND FOR AFFORDABLE HOUSING."

We have also included recomendations to President Reagan of the "President's Commission on Housing". Exclusionary and restrictive zoning practices as barriers to affordable housing have thus been deplored by officials at the highest level in two successive Administrations.

THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING

"STATES AND LOCALITIES SHOULD REMOVE FROM THEIR ZONING LAWS ALL FORMS OF DISCRIMINATION AGAINST MANUFACTURED HOUSING."

. . .

"BECAUSE OF SHARPLY RISING HOUSING COSTS, MANUFACTURED HOUSING TODAY OFFERS MANY HOUSEHOLDS THEIR *ONLY* OPTION FOR HOME OWNERSHIP."

. . .

"EXCLUSIONARY ZONING PROVISIONS BASED ON TYPE OF MANUFACTURE ARE ARBITRARY AND UNRELATED TO LEGITIMATE ZONING CONCERNS."

What we believe would be in the public interest is to require local governments to allow HUD-code constructed manufactured homes to be placed on residential lots where site-assembled homes of the same size and type could be built. If local zoning had a residential AAA-1 district which required three acre lots, a minimum of 3,500 square feet, and all brick or masonary exterior construction, we believe that a manufactured home should not be excluded *—provided that it can meet these land-use restrictions.* Likewise, manufactured homes should be allowed in all other residential districts where the particular lot size, set-back, off-set, and size requirements can be met.

However, Mr. Chairman, I must also point out that zoning practices in many cities and the tremendous delays which almost always result from applications for zoning changes are very, very expensive and costly and directly affect the cost of housing for home buyers. As an example, I have for distribution a news clipping from the Houston Chronicle which succinctly states the advantages and cost savings which result from a lack of restrictions.

The Federation appreciates fully the reluctance of the Congress or executive agencies to become involved in zoning matters, traditionally the province of local governments, but the persuasive influence of the Congress and the agencies can be exerted in various and sometimes subtle ways.

WHAT CONGRESS CAN DO

ZONING

Disqualifying local governments' participation in Federal Housing Programs if manufactured homes are excluded or unreasonably restricted.

HOUSING PROGRAMS

Including in Committee language reporting out all housing bills that it is the specific congressional intent that manufactured housing shall be afforded parity with site-assembled housing, and that expedited procedures shall be established by municipalities for permits for residential dwelling construction and zoning changes if necessary.

Substantial strides have been made recently in secondary market finance sources for manufactured housing. However, much remains to be done and our industry continues to work on new secondary finance markets. About the only thing that the Congress can do in this regard is to assure that manufactured housing is given equality through parity in the various statutes relating to the financing of housing and in federal housing programs. One specific request, however, is that the Federal Home Loan Mortgage Corporation be given statutory authority to establish a secondary market for manufactured homes only which are placed on rented or leased land—or on land owned by parents or other relatives.

The Farmers Home Administration should be required by statute to treat manufactured housing placed on a permanent foundation equally with site-built housing. I am sure you will hear substantially more on this subject when you have your hearing on rural housing later this month.

We have added the fifth item, "non-essential HUD standard requirements", not because the present code contains unreasonable specifications, but rather because it is our understanding that the Department of Housing and Urban Development will be submitting to the Subcommittee, in the very near future, a proposed rule which contans a number of code revisions. While the Federation has not been furnished the details of these proposals officially, we did note Senator Lugar's remarks on this matter which apeared in the January 26 issue of the Federal Register. Until the specific revisions appear in the Federal Register, Mr. Chairman, it is inappropriate for us to do more than express the hope that the cost impact of the proposed revisions will not be inconsistent with this Committee's concern for housing affordability.

SENATOR LUGAR
ON STANDARDS

"ONE PROPOSED SET OF REVISIONS WOULD INCREASE THE RETAIL PRICE OF A SINGLE-WIDE MANUFACTURED HOME BY ALMOST $1,400 AND INCREASE THE PRICE OF A MULTI-SECTION HOME BY ALMOST $2,200."

"SUCH COST INCREASES ARE ESPECIALLY TROUBLING BECAUSE MANUFACTURED HOMES ARE THE ONLY HOMES PEOPLE OF MODERATE MEANS CAN AFFORD."

Source: Congressional Record
January 26, 1983.

Chairman Tower, Congress has mandated and HUD has prescribed the mandatory building code for manufactured housing. This undertaking should assure that safe, decent, desirable, energy-efficient, and affordable manufactured homes should be available to help alleviate this nation's housing shortage which is growing each day and which, in my opinion, wil be awesome in another three to five years. As Senator Lugar has pointed out, our industry does not oppose changes in the code requirements and standards which might be essential to the public health and safety. However, Mr. Chairman and Committee members, the various competing aspects of the public health and safety must be reconciled. It is possible from an engineering standpoint to build a home that will not burn; we could build a home that was so energy efficient and thermally sealed that the carbon dioxide from normal breathing of the occupants and the resulting oxygen dissipation would kill them. It's like many other things—automobiles, television sets, heaters and furnaces, and the list could go on and on—we can protect the health and safety of the public to the extent that these items are too expensive for the vast majority of Americans to purchase. Few families would be able to buy a totally fire-resistant home, but many might freeze to death because of a lack of housing.

Thus, the HUD-code standards and requirements (like all recognized building codes) should be carefully and seriously weighed as to the adverse impact on the affordability of housing. The public interest in afforable housing must be a major consideration and changes should be made only if essential for the public health and safety.

In summary and conclusion, I thank the Senate Housing Subcommittee and Senator Tower as Chairman for the invitation to testify today.

We believe that you must specifically and expressly include manufactured housing in any and all plans for housing assistance in this country. We believe that manufactured housing today deserves equality through parity with site-assembled housing. We have no conflicts with the traditional homebuilders but desire to supplement the construction of housing for American families. We want to work with the traditional homebuilders to eliminate the exclusionary, restrictive, and expensive zoning regulations of many municipalities. We want to get on with our job of building homes and providing needed shelter.

However, in closing, I must lay out a challenge to this Committee, Mr. Chairman. If the 1983 Housing Act could somehow allocate a specific portion of public housing assistance funds and community block grant funds for the utilization of manufactured housing without unreasonable restrictions, our industry will provide 30% to 40% more housing of equal or better quality for each allocated dollar than the dollars spent on other kinds and types of housing in these programs.

Hear our plea! Give manufactured housing its opportunity! We can help you provide more housing for needy families and help cut the federal budget at the same time. Also with your assistance in eliminating discriminatory exclusions and restrictions and in resisting non cost-effective code standards, our industry can add 50% to the available supply of single-family residences for American families in the low, middle, and upper middle income ranges.

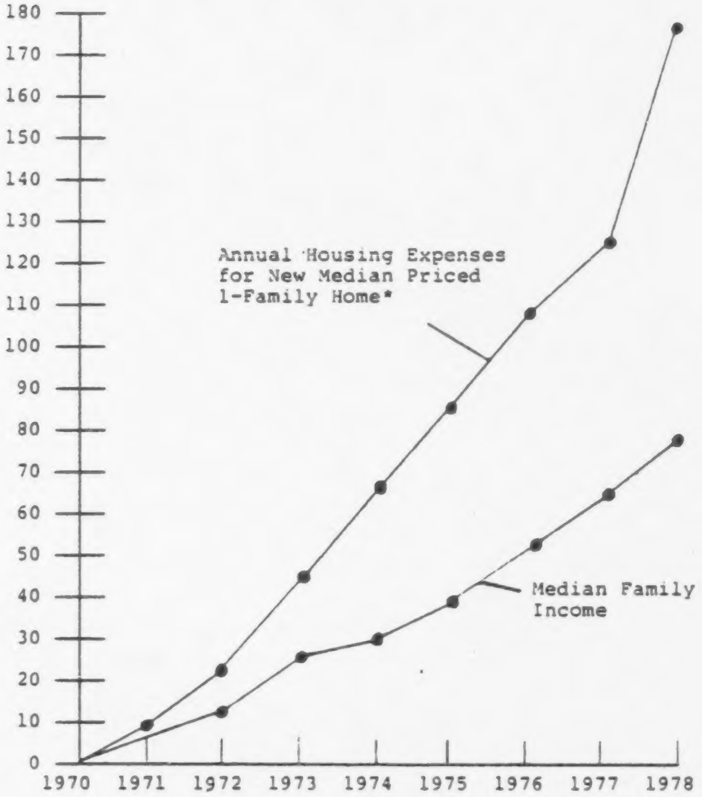
Thank you very much.

Exhibit #1

CHART ONE

INCREASING COST OF HOUSING

In the last decade, housing cost increases far outpaced increases in median family income.



* Including mortgage, maintenance, and utility expenses.
Sources: Economic News Notes Monthly Report (National Association of Home Builders), July 1979.
U. S. Bureau of the Census, Current Population Reports, series P-60, no. 123, June 1980.

Exhibit #2

CHART TWO

MANUFACTURED HOUSING AND SITE-ASSEMBLED HOUSING PRICE COMPARISONS

MANUFACTURED HOMES	1981
Average Sale Price (All Lengths & Widths)	$19,900 ①
Cost Per Square Foot	$19.13
Average Square Footage	1,040 sq. ft.

SITE-BUILT HOMES	1981
Average Sales Price	$83,000 ②
Cost Per Square Foot	$39.06 ③
Average Square Footage (Living Space)	1,700 sq. ft.

Source: Manufactured Housing Institute

① Includes Furnishings, but excludes land and installation costs

② Excludes furnishings, but includes land

③ Excludes furnishings and land

CHART THREE

Material and Labor Costs, Breakdown for a Typical Manufactured Home Manufacturer (Only Materials, Direct and Indirect Labor are Included)

Component	% of Total Cost	Item
Chassis/wheels	12	Chassis, wheel/axle assembly (excluded heating, plumbing, electrical)
Floor	10	Framing members, subfloor, underflooring, insulation, vapor barrier (excluded floor finish, heating, plumbing, electrical)
Exterior wall	15	Framing members, exterior siding, interior paneling, insulation, vapor barrier (excluded wall finish, heating, plumbing, electrical)
Roof	8	Framing members, trusses, exterior roof & subroof, ceiling insulation & vapor barrier (excluded ceiling finish ventilation fans, electrical)
Interior partitions	5	Framing members, paneling (excluded wall finish, heating, plumbing, electrical)
Doors & windows	7	Fixed & operable window units, exterior & interior door units
Exterior finish	0	Exterior painting, shutters gutters & downspouts, other exterior trim & ornamentation
Interior wall finish	2	Interior painting, wallpaper, vinyl wall covering, baseboard, other wall trim
Floor finish	3	Linoleum & vinyl flooring, carpeting & pad

CHART THREE
Continued

Ceiling finish	2	Ceiling tile, planks, panels, plaster or painted ceiling
Heating & ventilating	3	Furnace, exhaust fans, heating ducts, grilles & registers (excluded air conditioner)
Plumbing	3	Hot water heater, water supply system, drainage/vent system, bath & kitchen fixtures, gas system
Electrical	5	Distribution panel, circuit breaker, wiring, switches and outlets
Kitchen equipment	15	Range, range hood, refrigerator, kitchen sink, cabinets, other storage, counter tops (excluded disposal, dishwasher)
Bathroom equipment	2	Bathtub & shower, water-closet, lavatory, medicine cabinet, lavinette
Furnishings	8	Furniture, beds, lamps, drapes
TOTAL	100	

Source: "Building Tommorrow: The Mobile/Manufactured Housing Industry", MIT Press

CHART FOUR

MANUFACTURED HOUSING

COMPONENT COSTS

COST ELEMENT	APPROXIMATE TYPICAL PERCENT OF TOTAL COST
Materials	71%
Direct Labor	14%
Indirect Labor	2%
Selling Expenses	1%
General and Administrative	5%
Plant Overhead	4%
Profit	3%
TOTAL	100%

Source: "Building Tomorrow: The Mobile/Manufactured Housing Industry"

CHART FIVE

MANUFACTURED HOUSING

RETAIL PRICES*

1981

Type of Home	Retail Price	Average Price
Single-Section	$ 7,500 to $28,000	$16,500
Multi-Section	$15,000 to $55,000	$26,800

Source: Manufactured Housing Institute

*Excludes land and installation costs

CHART SIX

COMPARISON OF MOBILE HOME SHIPMENTS AND SALES OF SINGLE FAMILY SITE-BUILT HOMES

SITE-BUILT HOMES*	1981
Homes Sold	436,000
Percent of Total Site-Built Homes Sold & Mobile Homes Shipped	64%
MOBILE HOMES	
Homes Shipped	240,000
Percent of Total Site-Built Homes Sold & Mobile Homes Shipped	36%
Total New One-Family Site-Built Homes Sold & Mobile Homes Shipped	676,000

UNDER $40,000 PRICE RANGE

SITE-BUILT HOMES*	1981
Homes Sold	29,000
Percent of Total Site-Built Homes Sold & Mobile Homes Shipped	11%
MOBILE HOMES	
Homes Shipped	237,000
Percent of Total Site-Built Homes Sold & Mobile Homes Shipped	89%
Total New One-Family Site-Built Homes Sold & Mobile Homes Shipped	266,000

* U.S. Dept. of Commerce, Bureau of Census Data Conventional Homes -- C25 Construction Reports

Exhibit #4

CHART SEVEN

WHY
FACTORY-PRODUCED HOMES COST
LESS

1. PREEMPTIVE FEDERAL CODE
2. VOLUME PURCHASING OF MATERIALS
3. SYSTEMS-ENGINEERED PRODUCTION LINE
4. TIGHT QUALITY CONTROL
5. LESS LABOR INTENSIVE
6. NO WEATHER INTERRUPTIONS
7. SHORTER PRODUCTION TIME (250 MANHOURS PER HOME)
8. SAVINGS IN PILFERAGE
9. SAVINGS IN INTERIM FINANCE COSTS

Foreword

A high priority of most American families is to fulfill the All-American dream of homeownership.

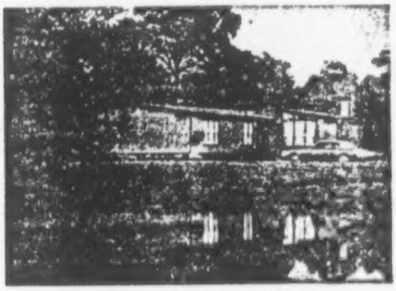
For many, however, that dream is slipping away because of inflation, high interest rates and escalating construction costs. An affordable answer is today's manufactured home.

Affordability, energy-efficiency, and quality construction are only some of the manufactured home's desirable features and best kept secrets. To fully explore the many virtues of this affordable housing alternative we invite you to read this booklet.

This booklet has been prepared and distributed by the Manufactured Housing Institute (MHI). Headquartered in the Washington, D.C. area, MHI is a nonprofit national trade association whose membership is comprised of manufacturers and suppliers engaged in building and servicing manufactured homes.

If you wish further information about manufactured housing please visit your local retailer or contact either your state manufactured housing association or the Manuactured Housing Institute, Public Affairs Department, 1745 Jefferson Davis Hwy., Arlington, VA 22202.

Why Manufactured Housing?



Because It's

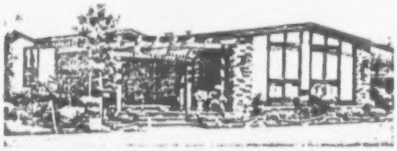
- **Affordable**
- **Built to National Construction Standards**
- **Energy Efficient**
- **Innovative**
- **Readily Financed**
- **and Insured**
- **Easily Maintained**
- **Attractively Sited**
- **Quality Housing That Appreciates In Value**

Affordable

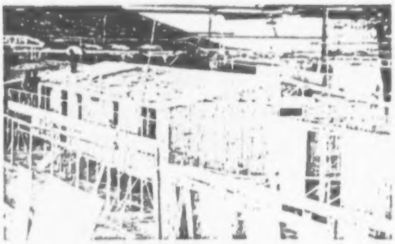
Currently, fewer than 5 percent of potential American home buyers can qualify for the loan on today's new average priced site-built house

Yet, the majority of American families *can* afford a new manufactured home.

With ever-increasing costs of buying a new site-built house, it's easy to understand why so many people are turning to manufactured homes to fulfill their housing needs. With an average price range from $10,000 to $50,000 for a completely furnished home—including carpeting, draperies, furniture, and all appliances, but not land—today's manufactured home is now accounting for one out of every three new homes being sold in the United States.

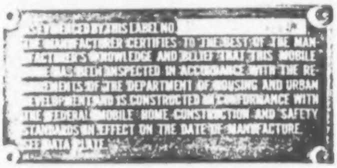


The manufactured housing industry is making affordable housing available today; homes that are built to a single national code stressing quality construction, energy efficiency, and occupant safety. Producing homes under factory controlled conditions with the latest in efficient production techniques, the manufactured housing industry is able to build year-round without interruptions from weather, and with the highest degree of quality control. All of these economies mean *you*, the consumer, *can buy more housing for less money!*



Built to National Construction Standards

Since June 15, 1976, all manufactured homes produced for sale in the United States are built to the rigid construction, durability, and safety requirements of the Department of Housing and Urban Development (HUD) standards for manufactured housing. These standards regulate the design and construction of the home, the frame and body structural provisions, as well as the installation and performance of the heating, plumbing, air-conditioning, thermal, and electrical systems.



EVIDENCED BY THIS LABEL NO.
THE MANUFACTURER CERTIFIES TO THE BEST OF THE MAN-
FACTURER'S KNOWLEDGE AND BELIEF THAT THIS MOBILE
HOME HAS BEEN INSPECTED IN ACCORDANCE WITH THE RE-
QUIREMENTS OF THE DEPARTMENT OF HOUSING AND URBAN
DEVELOPMENT AND IS CONSTRUCTED IN CONFORMANCE WITH
THE FEDERAL MOBILE HOME CONSTRUCTION AND SAFETY
STANDARDS IN EFFECT ON THE DATE OF MANUFACTURE.
SEE DATA PLATE.

Affixed to the outside of every home is a red and silver metal plate, known as the HUD seal, which certifies that the home was built in compliance with the Federal standards. Also for the consumers' protection, a manufacturers' compliance certificate which outlines specific design information is posted inside the home.

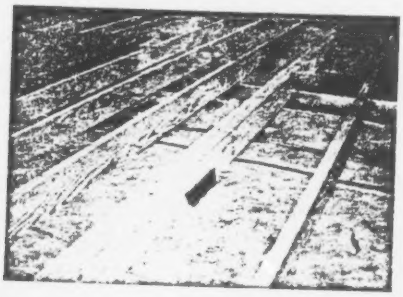
All appliances and furnishings are under warranty from their original manufacturer or supplier, and carry the same terms as if you purchased them from a local retailer. Ask your salesperson for the warranty that comes in writing with every home, and compare the responsibilities of the manufacturer and retailer who will provide you with *the best home your money can buy!*

Energy Efficient

Today's manufactured home is energy efficient!

There are two reasons for this fact. The first is the effective use of space found in all manufactured houses. The second and most important is that the home is constructed to the HUD Code which mandates thermal protection design requirements, including air infiltration calculations, and heat loss properties of the home. Total efficiency of space combined with the stringent energy-saving standard make this an energy-efficient home!

In addition, most manufacturers offer optional energy-saving packages that exceed the already steep minimum requirements of the Federal standards. *Dollars invested in energy-saving features will pay for themselves time and time again in future fuel-cost savings and resale opportunities!*



Innovative

With approximately 180 manufacturers producing homes from about 410 factory sites throughout the nation, the choices in architectural designs, floor plans, interior decors, and exterior finishes are virtually limitless in today's manufactured housing. There are great rooms, dens, saunas, formal living rooms, informal dining areas, and country kitchens. One can choose from French Provincial, Early American, Danish Modern decors; Cathedral ceilings, bay and greenhouse windows, stucco siding and slate shingle roofs. Just about anything that's currently available in housing is available in a manufactured home!

The manufactured home offers any size family the floor plan and square footage it wants and needs. The single-section home, which is the most popular and economical, varies in size from about 700 to 1,100 square feet of living space. The multi-section home is usually two or three sections, but can be four or more. These sections are built and then transported separately to the site, and there joined together to make a single-family residence.

The single-section home ranges in price from $10,000 to $25,000 and the multi-section home usually costs $17,500 to $50,000. Customized manufactured homes can cost more. Only the pocketbook and imagination of the purchaser limit the endless possibilities in today's manufactured housing.

Readily Financed

Traditionally, the manufactured home has been financed on a retail installment contract with everything included in the purchase price—the home with all furnishings, plus delivery, and siting. Again, land costs are extra. The foundation system, landscaping, and exterior amenities, such as carport, porch, and steps, can be added to the same contract as options. The downpayment is normally 15-20 pecent. Your choice of financing can usually be arranged through your manufactured home retailer.

Other sources of financing include banks, savings and loan associations, your company credit union, and commercial finance companies. You might also want to check to see if you qualify for an FHA insured loan or a VA guaranteed loan. If you live in a rural area, you might be eligible for a Farmers Home Administration loan.

If the manufactured home is sited on your own property, then a real estate mortgage can apply, but the furniture will have to be deleted from the contract. If you still wish to purchase and finance the furniture package, a tandem personal goods contract can be used. Once again, check with your retailer or local lending institution about the best terms available.

and Insured

Insurance is required by lending institutions on the home itself and is usually included in the financing package. You should also consider additional coverage for liability and loss of personal effects. This service is obtainable through your retailer and its lending source. Remember, though, it is always wise to shop and compare with your own agent and other insurance companies.

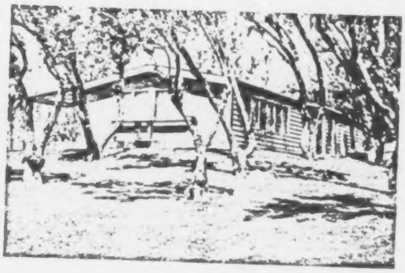
Easily Maintained

Although no home is maintenance free, a modern manufactured home affords its purchaser a residence that is easy—and inexpensive—to maintain.

There are easy-care materials, like a wide variety of wood paneling and attractive vinyl wall coverings used throughout the interior of the manufactured home. Combine this with a most efficient use of space and you have an easy-to-care-for interior.

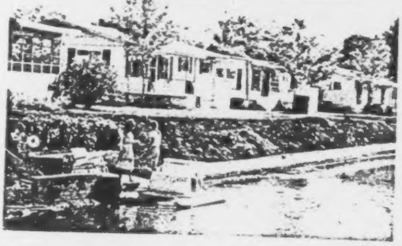
The same is true on the outside of the home. The manufactured housing industry takes advantage of the best exterior finishes available to home builders—hardwood paneling, cedar siding, pre-finished aluminum horizontal lap siding, and color coordinated vinyl siding—just to mention a few.

These low-maintenance features afford you the time to enjoy your new manufactured home!



Attractively Sited

Manufactured homes are sited on either rental sites or the purchaser's own land, with an increasing trend toward subdivision, cooperative and even condominium developments. Manufactured home communities are environmentally attractive and appealing, offering a comfortable and inviting lifestyle for all types of families, young or old.



As a rule, the rental sites are in planned developments, ranging in size from as small as 15 sites in the community to 1,000 or more. The price varies from about $50 a month for a very minimum service development, to well over $300 a month for a luxurious community offering many amenities, services, and a variety of recreational facilities. The majority of developments have a monthly rental charge in the $80 to $150 range.

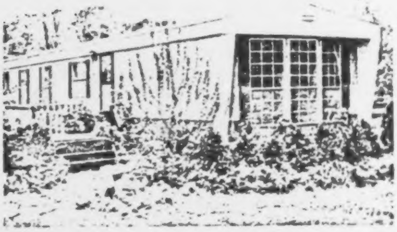
Planned communities are often designed to cater to a specific kind of homeowner—young families with children, adults only, or senior citizens. Select the development that best suits your particular lifestyle and needs.

When looking for the community of your choice, your retailer is probably the best qualified person to advise you on what's available in your area. Before making a decision be sure you know the terms of the lease in addition to the rules and regulations specific to that community.

The other option for siting your manufactured home is to own the land with the home. Today this occurs in four ways—subdivision, condominium, cooperative, or scattered-lot siting. Typically, your purchase will be through a developer who will sell you a land/home package.

If you plan to site your new manufactured home on your own land, you would purchase the home from a retailer and wisely seek his counsel and services. A check of the zoning ordinances applicable to your site should be the first step on your agenda and can be done through your local courthouse or city hall. Once these stipulations are met and the permits acquired, then site preparation can begin.

Whether the home is to be placed on leased land or your own lot, *be sure you have the site selected and signed for before you agree to purchase the new manufactured home of your dreams!*



Quality Housing That Appreciates in Value

Today's manufactured home is comparable to, and can be compatible with, site-built housing. It is constructed similarly to a site-built house utilizing the same building materials. This gives the manufactured home the same durability capabilities as a house constructed on site.

Whether the home is in a planned development where the site is rented or on your own property, if it is well-located, properly maintained, and then sold on-site, it will appreciate in value. A manufactured home that is suitably sited on an appropriate foundation system and well landscaped will retain its value and *appreciate* in accordance with surrounding properties and the escalating cost of housing.

According to a recent study by a major insurance company, manufactured homes built since 1973 appreciated in value from 5 percent to 27 percent per year on a nationwide basis.

A manufactured home can be your affordable housing answer—as well as the home of your dreams!

That's why manufactured housing!!

In Appreciation

The Manufactured Housing Institute acknowledges and thanks Citicorp Acceptance Company, Inc., headquartered in St. Louis, Missouri, for its assistance in the preparation of this booklet.

MANUFACTURED HOUSING QUARTERLY

WINTER 1983

Land Use, Financing and Trends in Affordable Housing

SOUTH BRONX—CROTONA SOUTH MANUFACTURED HOUSING SUBDIVISION SITE PLAN

MH Inner-City Subdivision Opens in the South Bronx, New York

Within one block of where President Carter in 1977 and candidate Reagan in 1980 stood "appalled" at conditions in that ravaged area of New York City there will be a 90-unit manufactured housing subdivision. It represents innovative new thinking about affordable inner-city housing, and, at prices in the $50,000 range, perhaps some calculated risks.

The South Bronx Development Organization (SBDO) will install the first two manufactured homes on Charlotte Street across from Crotona Park to serve as models. The firm will follow these with eight more in the same block. If the first ten homes sell—and Ed Logue, SBDO President, is sure they will—the additional eighty homes will be located in a 10-block area to be known as Crotona South.

According to Robert Garcia (D-NY) who represents the Bronx in the U.S. Congress and who serves on the Housing Committee: "In order for us to rebuild the Bronx and increase the well being of our neighborhoods, we need to provide homeownership opportunities to moderate and middle income hispanic and black families. Manufactured housing is an innovative way to create this opportunity."

"We believe manufactured homes are a sensible answer to expanded homeownership in the South Bronx," says Logue. "If anyone doubts that a market for middle-income housing exists here, I'd remind him that last year we sold 250 brick row houses in this area which ranged in price from $51,000 to $61,000. We actually had to turn people away!"

Logue adds that these row houses were developed and sold under the HUD 235 interest-subsidy program which meant that some people couldn't qualify because their incomes were too high.

"Now that this housing subsidy program has been eliminated," he says "the lower initial cost of manufactured homes permits families

Manufactured Homes Capture Over One-Third of U.S. Housing Market

Last year more than one-third of all new single-family homes sold in the U.S. were built inside modern factories and then transported to the home site.

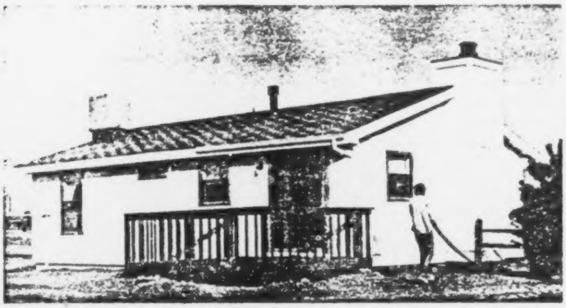
In a year when site-built home sales dropped to their lowest level in nearly two decades, sales of new manufactured homes held nearly even in 1982. Manufacturers shipped a total of 238,808 homes last year, a less than 1 percent decrease from the 240,313 manufactured homes sold during 1981.

By contrast, some 413,000 new site-built houses were sold in 1982, a 5.3 percent decline from the previous year. If you add the site-built and manufactured housing sales totals together, you get 651,808 new single-family homes sold in America last year. Manufactured homes accounted for 36.6 percent of that total, or better than one-third.

Contributing to the relatively strong manufactured home sales picture for 1982 were two consecutive months of heavy sales increases. In December, the manufactured housing industry sold some 16,000 homes throughout the nation, a 13 percent boost over the same month a year ago. During November manufacturers registered a 20 percent sales increase from the identical month a year ago.

In this issue of MHQ

- Summary of S&L NEWS MH subdivision article, P2
- VA Loan Guarantee Program report, P3
- MH INVESTMENT OUTLOOK, P4
- Update of legal, legislative actions by states, P5
- Pictorial recap of Elkhart Affordable Housing Symposium, P6



Typical multi-section manufactured home being installed in the Brookwood subdivision of Grand Junction, Colorado.

MH Subdivisions Topic of SAVINGS & LOAN NEWS Article

With all the talk about "explosive growth" in manufactured housing subdivisions, many of them encouraged by the Federal National Mortgage Association's (FNMA) MH mortgage loan purchase program, SAVINGS & LOAN NEWS wanted to know if THIS would be the year when promise becomes reality. While no conclusions could possibly be reached to so complex a question, a feature article in the February 1983 issue suggests that this will be the *first* year of many.

Featured is the 110-home project at Grand Junction, Colorado, for which Shelter America Corporation, a subsidiary of Western Federal S&L, provided both construction and permanent financing. Similar projects are opening this spring in Wyoming, Nebraska, New Mexico, Oklahoma, and Texas.

The Grand Junction homes are multi-section models with 1,100 to 1,800 square feet, three or four bedrooms and two baths, and including carport or garage. To satisfy FNMA "marketability" requirements, they all have shingled roofs and natural material exteriors. They are being offered with FNMA-approved 30-year fixed-rate financing for $54,000 to $68,000 including land.

Mobile Home Industries, a Florida-based manufactured home builder, is discussed in the article as providing a blend of single-section and multi-section homes for five new subdivisions, including a 500-unit project in the Fort Myers area of Florida. Also mentioned is General Development Corporation (GDV), a City Investing subsidiary, which recently sold the last of its 800 manufactured homes at Fort Malabar, Florida. GDV is now marketing a new 640-home subdivision just north of Melbourne, Fla.

While admitting that these few projects hardly tell a complete story, the article substantiates what Donald G. Shirk, President of Shelter America, is quoted as saying: "In 1983 I think you'll see many more manufactured housing subdivisions starting up, and from there it will spread fast."

John Courson, President of Fort Wayne Mortgage Company, a major midwestern mortgage banking concern, added this personal observation: "We see our company's future tied into the MH subdivision because that's where the market potential is the greatest."

However, the S&L NEWS article notes that few savings institutions are committed to manufactured housing at this time. Several reasons are cited by thrift executives, including an apparent reluctance by these institutions to become involved in new government procedures. Most agree this will change gradually, motivated by the fact that manufactured homes now account for 36.6 percent of all new single-family homes sold in this country...this, the article concludes, before the impact of the MH subdivision trend has even been felt!

Input Needed for Study of MH Zoning Reforms

Urban Research and Development Corporation, a Pennsylvania housing consulting firm, is conducting a study for HUD's Joint Venture for Affordable Housing and would like relevant information from readers of MHQ.

The purpose of the study is to determine how state and/or local government changes in land use and zoning policy have resulted in manufactured housing developments "as one method of increasing affordable housing opportunities." Or, where such reforms will lead to new homeownership opportunities for middle-income families.

"The idea," says Martin C. Gilchrist, Executive Vice President of URDC, "is to accumulate and summarize specific case histories of cooperation between local government officials and developers or manufacturers which have brought about regulatory changes more favorable to large-scale use of HUD-Code manufactured houses, as in condominium or cooperative projects, clusters, parks, or owner-occupied subdivisions."

The firm is in touch with state governments and manufactured housing state associations, but they really want individual experience at the local level. And with some 50,000 cities, towns, and counties as possible sources, Gilchrist admits they need some voluntary input.

"Ideally, we would like to hear from communities where local officials, presumably with citizen support, have themselves initiated new policies to encourage large-scale use of manufactured housing to meet their housing needs. Usually, it's the other way around, the developer in partnership with the manufacturer having to push for updated policies...and sometimes having to go to court to get them!"

Gilchrist points out that this is a good opportunity for the MH industry and its supporters to contribute to a document that will help promote favorable regulations in other areas of the country and, eventually, everywhere.

The address of Urban Research and Development Corporation is 528 North New Street, Bethlehem, PA 18018. You can reach Marty Gilchrist at 215/865-0701.

MANUFACTURED HOUSING QUARTERLY
Land Use, Financing and Trends in Affordable Housing

MANUFACTURED HOUSING QUARTERLY is published four times a year by the Manufactured Housing Institute (MHI), a non-profit national organization representing manufactured home builders and their supplier companies.

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VA Nears $1 BILLION in MH Loan Guarantees

Since the Veteran's Administration (VA) manufactured home loan guarantee program began in 1971, the VA has approved 62,324 applications amounting to $963,981,626.

More significantly, reports George Alexander, Staff Assistant for Manufactured Housing at VA headquarters, there has been a steady 10 percent or more growth every year since 1976 when the HUD manufactured housing standards first went into effect. In 1982 the VA approved some 10,000 MH loan applications.

"The program has come along just the way we wanted it to," says Alexander. "We haven't wanted explosive growth, just steady growth on a firm foundation, and this is what we have."

"Explosive growth" inevitable?

There are signals that the pace may be quickening. November, for example, registered a 16 percent increase over November of 1981 and December was a real shocker—up 42 percent from December a year ago.

Whether this does amount to "explosive growth" won't be known for a while, says Alexander, but he points to concurrent and comparable trends in other Federal MH programs.

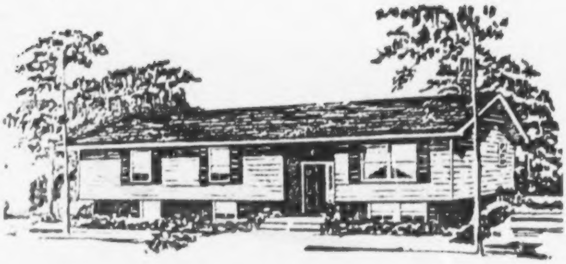
"For one thing," Alexander points out, "active involvement by the Federal government gives new credibility to manufactured housing. This combined with the growing demand for affordable single-family homes probably means we're in for a busy time during the next few years."

Middle income families

Alexander reports that of the 1,278 MH loans guaranteed last September, 946 were for single-section models costing an average of $18,466 and 332 were for multi-section models averaging $25,124. Actual loan amounts depend on down payments and whether the house is sited on rented or veteran-owned land, but they averaged between $19,490 ("Home Only") and $26,185 ("Home and Land" packages).

Of special interest to Alexander is the fact that the average household income for these veterans was $21,540 which is very close to the national average for all families. He also expresses satisfaction that 40 percent were 30 years or younger in age, and many were in-service personnel.

"It's evident from these figures that we're helping those younger families who have had no chance of getting into the stick-built market."



Architecht's rendering of multi-section manufactured house with basement being installed in the South Bronx.

South Bronx MH Subdivision to Open

continued from page 1

with moderate incomes to afford them without federal subsidies." Peter Bray, SBDO Project Manager for Manufactured Housing, feels this development is unique in several ways, most notably in that it "reverses" the usual in-fill concept.

"Inner city in-fill usually means sticking a few houses in among a greater number of larger, existing structures. With the discontinuation of the HUD Section 8 'Deep Rehab' program, most of the 4- and 5-story multi-family apartment buildings have to be demolished. Only one, or at most two, apartment structures will be left on each block, so we're effectively changing the character of the neighborhood to middle-income single-family homeownership."

It's also important to understand, Bray says, that Crotona South is now abutted by "stable" communities of mixed character.

"We're aiming to bridge the gap, to bring this area up to comparability and extend residential stability throughout the entire section of the South Bronx. Offering people attractive manufactured houses on their own land gives them a sense of involvement...of being an integral part of their own neighborhood. This translates into stability."

The inner-city MH subdivision

The first two houses are typical multi-section models—24 x 48 feet overall providing 1,152 square feet of living space. They include three bedrooms and one and a half bathrooms, plus advanced kitchen designs and cathedral ceilings. With land they are priced at about $50,000, although the model with the full basement will be a bit more. Fixed-rate 30-year mortgages of 12½ percent are made available through the State of New York Mortgage Agency.

Bray tells of one unexpected problem that caused the first manufactured homes to be priced higher than desired.

"We found we had about fifteen feet of rubble left after demolishing an apartment building. Rather than haul it away, we use what we call 'Dynamic Compaction.' A 100-foot crane drops a 6-ton cylinder according to a grid pattern which compacts the rubble so thoroughly the footings and foundations can be poured right on top of it. Doing this for just a couple houses proved expensive, but by the time we get going on several lots at once, the process will cost less so each house can be sold for less."

A public and private sector partnership

SBDO, aided by the Local Initiatives Support Corporation, spearheaded the planning and implementation of this project and the Mid-Bronx Desperadoes, which has carried on its own highly-successful housing rehabilitation program, is co-sponsoring Crotona South. It combines capital from the State Division of Housing and Community Renewal, with mortgage lending from banks operating in conjunction with the State of New York Mortgage Agency.

"Manufactured homes can be an answer in many parts of the city," says Logue. "These homes, however, have an added importance for the South Bronx. Charlotte Street will be transformed from a national symbol of urban decay to an exciting experiment aimed at the housing needs of the inner city."

INVESTMENT OUTLOOK

MH Investment Experts See 'Explosive Growth' ...with Certain Conditions

In its December 3rd issue, the VALUE LINE investment service weekly report featured an overview of the manufactured housing industry's prospects as a whole before offering specific MH stock recommendations (which we cannot include, for obvious reasons). A few quotes speak clearly for themselves, and the VALUE LINE outlook.

"We think manufactured housing will outperform the economy during the year ahead and to 1985-87."

"The manufactured housing industry now ranks 5th out of 93 (industry categories) for the year ahead in market performance."

"We look for explosive growth in manufactured housing over the 3-to-5-year period fueled in part by the marriage of real estate know-how to manufacturing expertise."

Just a few weeks later, in its December 31st year-end review and forecast issue, VALUE LINE again touted industry prospects in more detail.

"In fiscal 1983, we estimate that a recovering economy and a further moderate decline in home mortgage rates will help boost manufactured home shipments nationwide by 10 to 15%. Over the next few years, we think manufactured housing will be increasingly used in subdivisions and be sold at the site like conventionally-built housing. Home-and-land packages now account for only about 5 percent of total shipments. Three to five years from now we expect them to account for 15 to 20 percent. The increasing popularity of manufactured homes could help shipments rise to 425,000 annually by 1985-87."

Two conditional expectations are evident in VALUE LINE's otherwise exuberant evaluations. First, that there will be a "marriage" between conventional and manufactured real estate elements. Second, that the home-and-land package concept does gain acceptance which is necessary before manufactured homes can "be increasingly used in subdivisions."

An "attractive vehicle" to Bob Curran of Merrill, Lynch

This is perhaps an unfortunate colloquialism since the MH industry is still struggling to shed the "vehicular" yoke. However, it's typical of investment jargonese, along with Curran's observations that today the listed MH company stocks are "working off a high base" which suggests there's a "correction coming" after which these stocks will surely be "one leg of the ultimate bull market."

Translated...and with due apologies for poking a bit of fun at one of the investment world's most qualified housing analysts...this means that Curran feels well-disposed towards the intermediate outlook but cautions about temporary setbacks possible in the next few months.

"Many of these stocks have experienced dramatic price rises for several months, starting well ahead of the general market rise of last August," he says. "This means they may be at or close to their near-term peaks and could drop back somewhat in the next two or three months along with the market as a whole."

This, he adds, is a time to hold onto MH stocks in the portfolio, but watch for possible price retrenchment before making any more commitments. (Editor's Note: This cautionary viewpoint held by Curran and many other analysts applies to the time this interview was conducted in early February. When you read this, circumstances may be quite different.)

Curran is bullish on the housing industry as a whole for the next one to three years, citing his belief that the Federal government is now committed to holding down interest rates as long as it takes to stimulate the economy. He sees manufactured housing riding along with other elements of the housing industry during the coming cyclical upswing, although he's less willing to offer a favorable projection into the latter years of the decade.

"Singular" as well as "cyclical" potential?

Whether manufactured housing stocks outperform the market, as forecast by VALUE LINE, depends, in Curran's opinion, on the industry itself. Manufacturers, he maintains, must achieve two critical breakthroughs...overcoming the all-too-familiar "image" problem, and adapting to the demands of the marketplace. These achievements are essential before the MH subdivision becomes a widespread reality. He agrees that this area represents the best growth potential for the industry.

Curran draws a parallel with the automobile industry. In trying to meet import competition, Detroit shifted to the compact and then the subcompact only to see the bulk of the middle-income business still going to Japan. Only when Detroit began shifting towards the intermediate model did the American manufacturers make inroads in foreign competition. This, he claims, is because the American car buyer still prefers the space and amenities to which he has long been accustomed. The subcompact market remains, but the greater potential for domestic manufacturers, in his opinion, lies in the "affordable family car" compromise.

This is why he feels the conventional home builder errs in downsizing his product to "subcompact" size which brings him up against the less-expensive single-section manufactured home, and why he feels the housing manufacturer has the opportunity to capitalize on the inherent American desire for an "intermediate" compromise, the "affordable family home."

Only if this happens, he adds, can manufactured housing establish its own singular growth pattern rather than just tag along on the next cyclical upswing.

"The consumer will not come to the door of the manufacturer and *insist* that he build a larger and better product," Curran cautions. "The consumer takes what's out there, so it's up to the manufacturer to anticipate and adapt."

Typical single-section manufactured home in landscaped subdivision setting.

Montana Court Ruling Highlights 'Comparability' of UBC and HUD Codes

The District Court of Butte-Silver Bow County, Montana recently ruled that manufactured homes built to HUD Manufactured Home Construction and Safety Standards (MHCSS) must be allowed in any single-family residential area within that county.

The case was brought by Harry and Lillian Martz in 1979, challenging an attempt by local officials to stop them from siting their home in a neighborhood zoned for residential use.

County zoning officials claimed that manufactured homes built to Title VI HUD standards are inferior to conventionally constructed homes allowed in residentially-zoned areas and built to the Uniform Building Code (UBC).

The District Court ruled without trial in 1981 that the county zoning ordinance was unconstitutional because it did not provide adequate space for manufactured homes and mobile home parks.

The county appealed the decision to the Montana Supreme Court on the grounds that the HUD code was inferior to the UBC code and manufactured homes, therefore, posed a threat to public health and safety. The Supreme Court sent the case back to the District Court requestng a trial of facts, and a comparison of the HUD and UBC codes.

Based on expert testimony, the Country District Court reaffirmed its earlier decision. Judge Arnold Olson ruled that there is *no distinction* between HUD and UBC codes in terms of public health and safety; therefore, manufactured homes built to the HUD code may not be excluded from residential neighborhoods.

The county has 90 days to appeal again to the Supreme Court. The defendants, along with the Montana Manufactured Housing Association, may request a Supreme Court ruling on the case which would strengthen other court decisions throughout the county and affect similar zoning issues statewide.

What other states are saying about manufactured housing

Vermont—"Municipalities cannot distinguish in their zoning ordinances between housing based on methods of construction...Permits must be issued for all single-family mobile, modular, or prefabricated housing in any zoning district that allows single-family conventional site-built dwellings if they meet the same land-use criteria as the site-built dwelling."

Indiana—"Ordinances may subject dwelling units and lots to identical standards and requirements whether or not the dwelling unit is a manufactured home or some other type of dwelling unit."

California—"A city or county shall not prohibit the installation of HUD-code constructed mobile homes on foundation systems on lots zoned for single-family dwellings."

Kansas—"Neither the Board of County Commissioners nor the Planning Board of any county shall...regulate the occupancy or location of dwelling units in such a way as to affect the arbitrary exclusion of manufactured housing."

Minnesota—"No regulation may prohibit manufactured homes...that comply with all other zoning ordinances promulgated pursuant to this section."

Nebraska—"...At least one such district in the municipality shall include both land zones for mobile home subdivisions and individually-owned lots in such mobile home subdivisions."

Florida—"...In no case may such local requirements and regulations have the effect of precludng mobile homes...from being installed as permanent residences, and they shall be treated by local governments in the same manner as conventionally constructed dwellings."

New Hampshire—"...the partial or total exclusion of manufactured houses in communities is based on outmoded perceptions as to the safety and quality of manufactured housing, and aesthetic factors. Manufactured housing, when built in conformance with national codes, is almost indistinguishable from conventional, site-built housing."

And now, New Jersey, based on Supreme Court decisions of January 20th, 1983—"As the cost of ordinary housing skyrockets for purchasers and renters, mobile homes become increasingly important as a source of low cost housing. Therefore, subject to the qualifications noted hereafter, we rule that municipalities...must provide zoning for low-cost mobile homes as an affirmative device in their zoning ordinances."

A western style manufactured housing subdivision.

Builders, Developers Attend Manufactured Housing Show

In addition to retailers from 39 states and 12,000 public attendees, nearly 500 "conventional" builders and developers from across the nation showed up to view more than 200 models on display at the Kentucky Fair & Exposition Center.

The Chairman of MHI's National Manufactured Housing Show Committee, Jim Miller, President of Brigadier Industries, explained: "The only way to make housing affordable for the average American family is to utilize the efficient factory home-building technology we already possess," said Miller. "That's why so many site builders are beginning to work with manufactured home builders who can provide them with the products they can sell. With their collaboration we can solve the nation's housing crisis."

A view of some of the thousands of attendees to MHI's 47th National Manufactured Housing Show held recently in Louisville, Kentucky.

Jerry C. Connors, President, Manufactured Housing Institute

I. Donald Terner, Director of the California Department of Housing and Urban Development

Keynote Speaker Donald I. Hovde, Under Secretary of the Department of Housing and Urban Development

Congressman John Hiler of Indiana

National Affordable Housing Demonstration Project Draws Large Crowd

More than 350 government officials, lending executives, planners, and representatives from all sectors of the housing industry converged on Elkhart, Indiana early in November to explore the vast potential of manufactured housing for solving America's housing crisis.

"The New American Neighborhood," a model manufactured housing community designated an Affordable Housing Demonstration Project by the Department of Housing and Urban Development (HUD), highlighted the two-day symposium initiated by Elkhart County and the National Association of Counties (NACo).

The demonstration project encompassed two mini-subdivisions of manufactured homes and one site where manufactured homes were installed among site-built homes. One of the two MH subdivisions featured multi-section models while the other featured some of the latest single-section models. All were installed on permanent foundations, attractively landscaped, and many featured add-on garages, carports, and even "breezeways" which were constructed by a local builder who helped develop the subdivisions.

According to Elkhart County Planning Director Dennis Harney who headed the Demonstration Project and Symposium, the manufactured homes will be sold with land, as real estate. Harney said that local banks have agreed to provide long-term mortgage financing.

HUD Under Secretary Donald I. Hovde, the keynote speaker at the symposium, said: "Manufactured housing functions like real estate, looks like real estate, holds its investment value like real estate, because it is real estate.

"This symposium is to wake up America that you can put a manufactured house next to a stick-built house and you would not know the difference," Hovde said.

Indiana Congressman John Hiler, another symposium speaker, said that manufactured homes would play a "vital role in providing affordable housing for America."

MHI President Jerry C. Connors noted that "discriminatory zoning continues to represent a serious barrier to the healthy growth of the manufactured housing industry." He called for a national reappraisal of housing policy to allow for greater MH use.

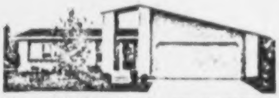
Other speakers at the symposium included Indiana Lt. Governor John Mutz, California Housing Director I. Donald Terner, and Dr. Thomas E. Nutt-Powell of the Harvard-MIT Joint Center for Urban Studies.

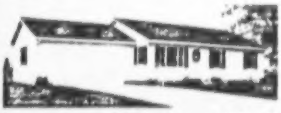
Stillwater, Oklahoma, announces its own Affordable Housing Demonstration Project

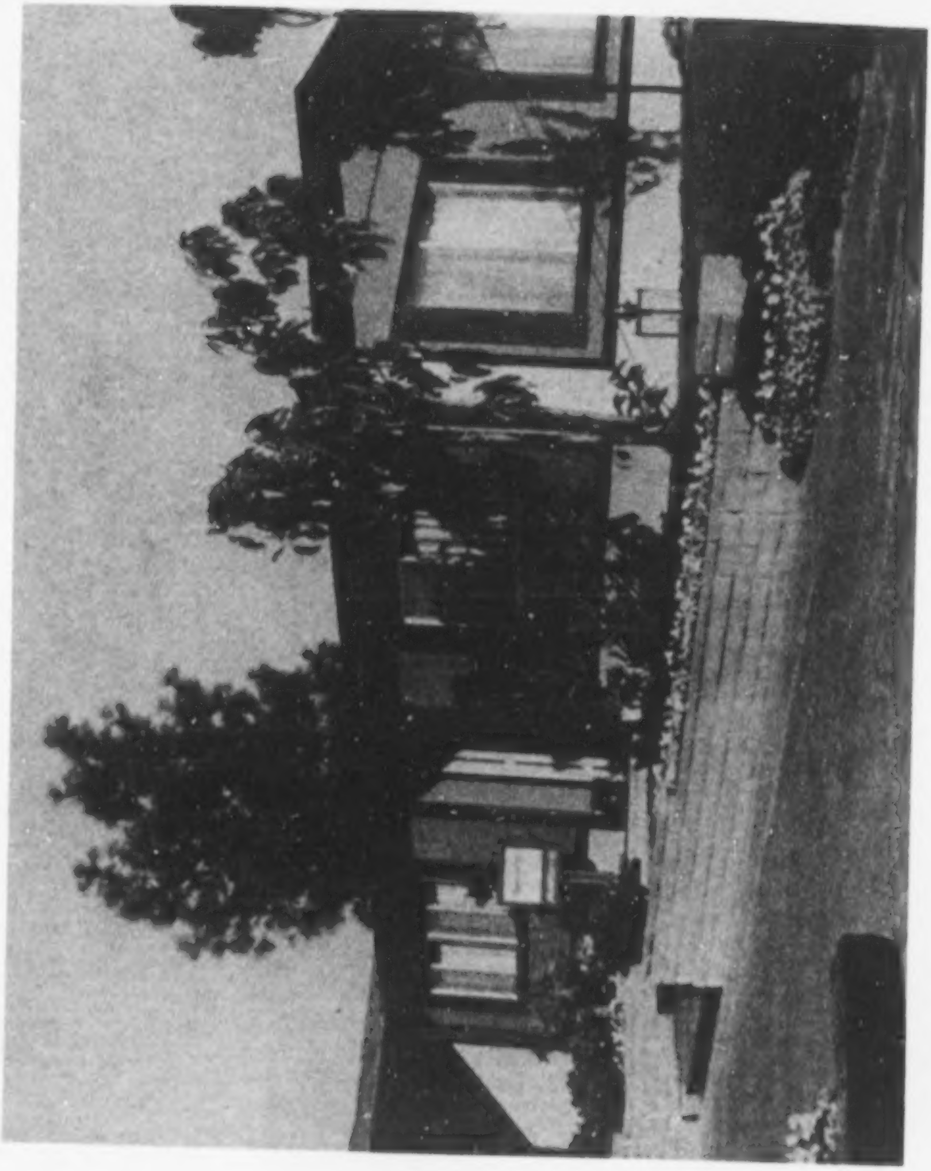
If the Elkhart County Demonstration Project was the first of 12 HUD-sponsored sites planned throughout the nation, Stillwater, Oklahoma is determined to be second. The manufactured Housing Association of Oklahoma (MHAO) announced jointly with HUD and the City of Stillwater an innovative 20-acre MH subdivision targeted to open this June.

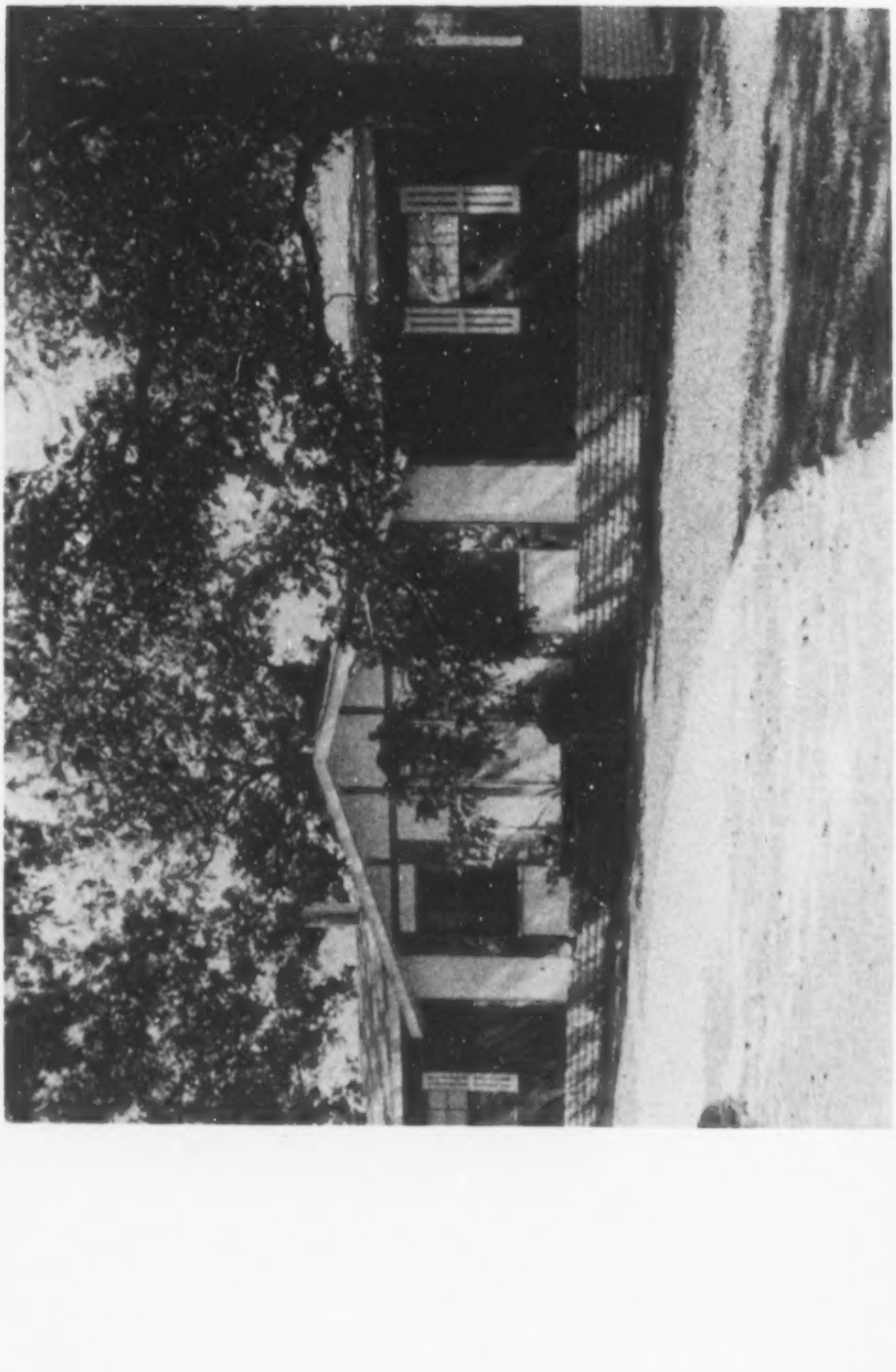
Initially, 15 single-section homes will be placed on standard-sized lots in a typical subdivision setting. The ultimate size of the project will be 85 to 90 homes, a mix of manufactured, modular, and conventional site-built designs.

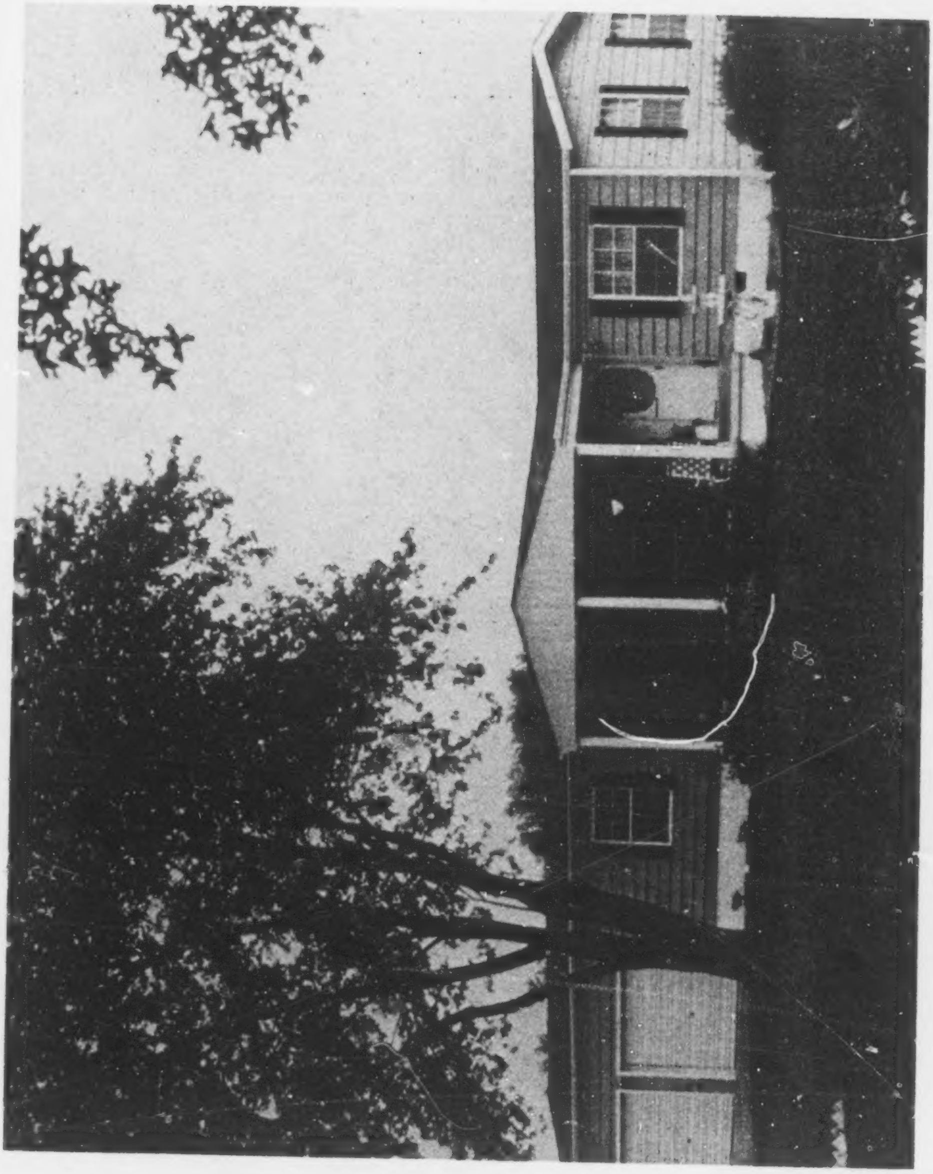
For more information, call Hal Bassett, Executive Director of MHAO at (405) 521-8470.

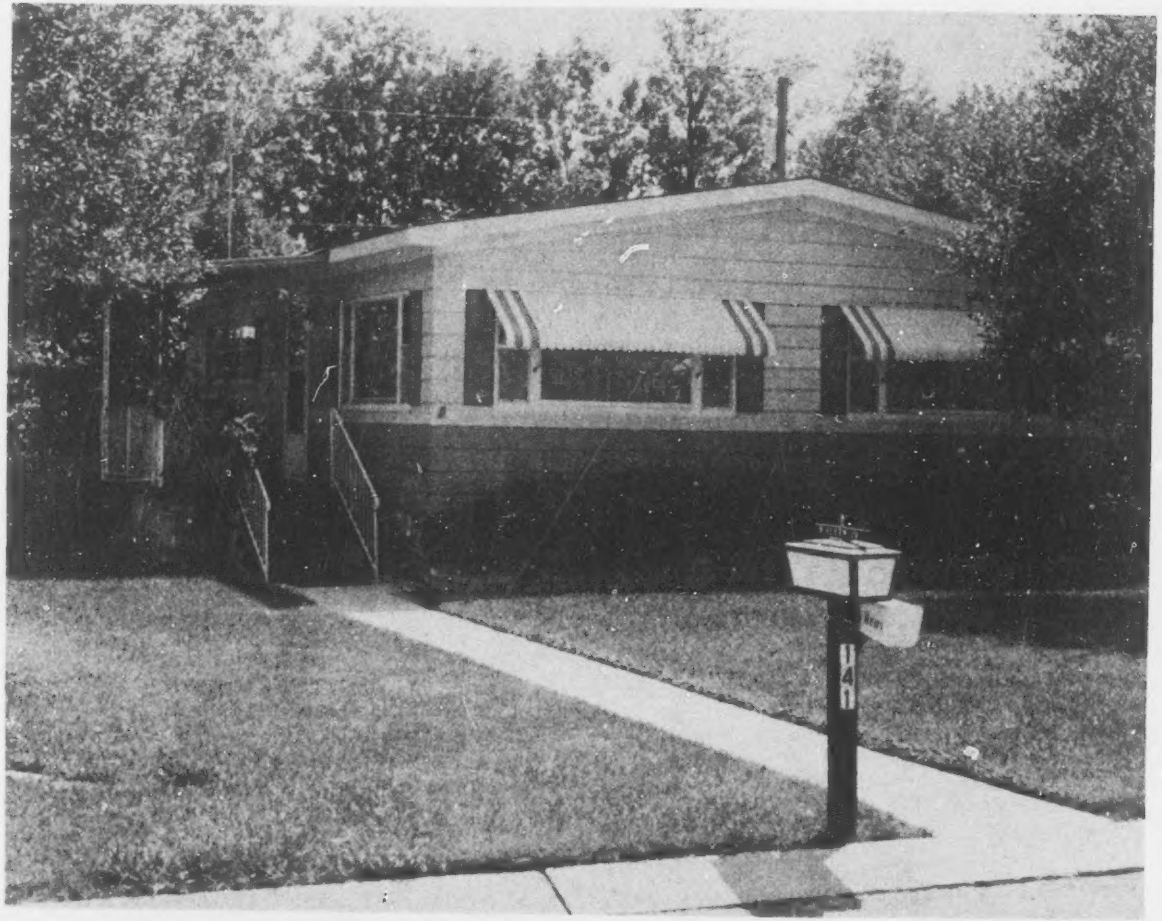


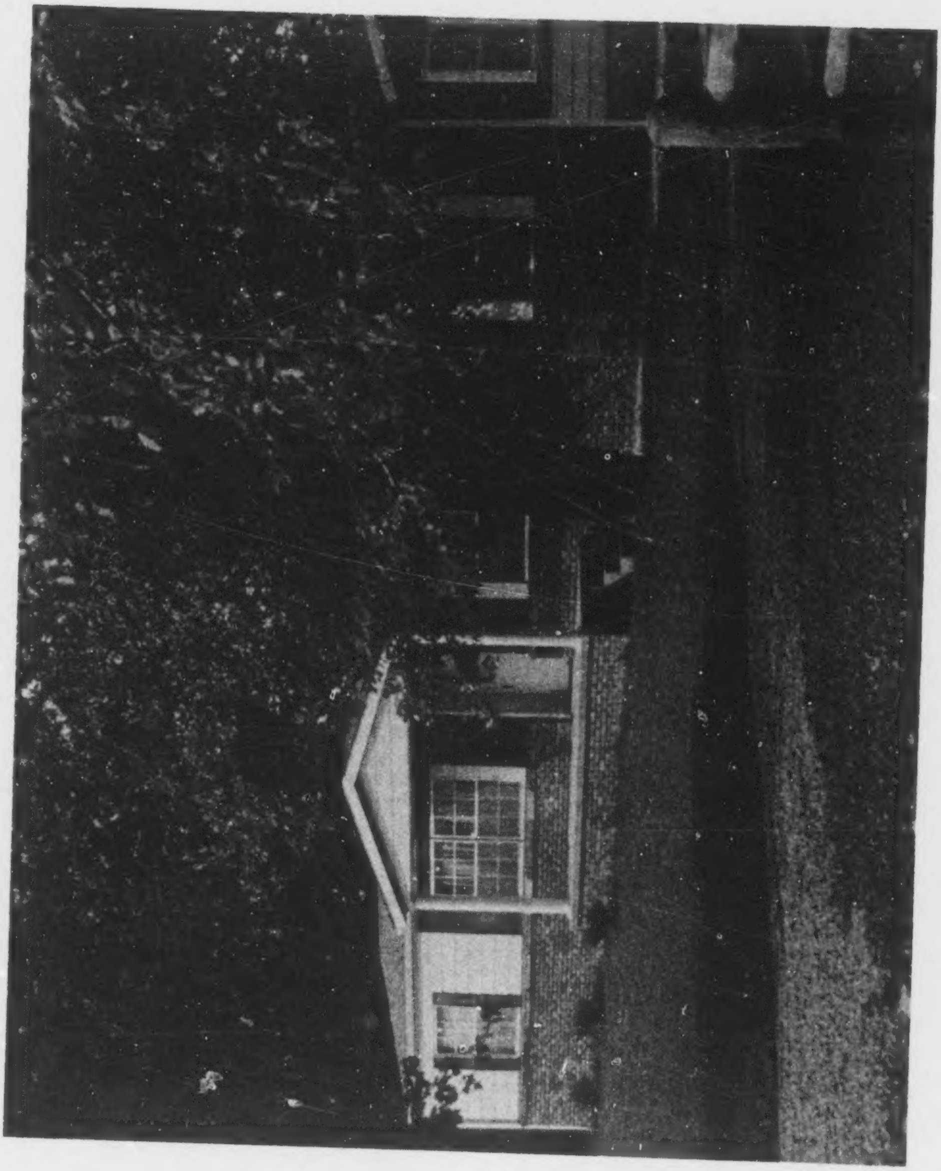












[From the Houston Chronicle Oct. 25, 1982]

LACK OF ZONING RULES GIVES LIFT TO HOUSTON HOME BUILDERS

Builders here are putting up more houses than they have in prior years—despite a rising unemployment rate, a downturn in the energy sector and, until recently, high interest rates which put homes out of reach for many.

Housing starts in Houston were strong during the first quarter of this year and posted a record during the second quarter. The figures for the third quarter, released last week, were the best third quarter in five years.

The nation's housing industry is depressed, yet Houston this year will lead the nation in housing sales and starts for the eighth consecutive year. In fact, some analysts say more homes will be completed and sold in Houston this year than ever before.

Why has Houston led the nation in starts for nearly a decade, with single-family homes selling nearly as fast as builders complete them, even in a depressed economy?

The answer, say industry researchers and analysts, is relatively simple: Houston doesn't have major zoning restrictions.

"This has permitted builders to match home affordability with consumer needs and preferences," said Warren Dold, market research coordinator for the Friendswood Development Co.

The lack of such ordinances restricting residential development may be responsible for the strong housing market in Houston, according to research compiled by Frendswood, a subsidiary of Exxon Company U.S.A. and a major residential and commercial land developer here.

The firm's researchers compared data on housing sales and construction starts in major metropolitan areas across the nation and concluded that, in part, Houston's lack of zoning has enabled builders and developers to respond rapidly to changing market conditions with homes that are "affordable, practical and stylish."

For example, the friendswood researchers discovered that the standard metropolitan statistical area of Los Angeles—an area with 12 million people that includes Long Beach, Riverside and Anaheim—isn't producing half the housing activity that Houston is.

"We asked ourselves why Houston was booming in single-family construction," explained Dold. "We came to the conclusion that the lack of zoning here was responsible in part."

The analysis showed that Houston builders and developers, unencumbered with highly restrictive residential zoning ordinances, have been able to react to changes in the home-buyer market quicker than those in most other cities because of the flexibility provided by Houston's free market system. All of the largest 25 SMSAs are zoned except Houston.

In other words, Houston developers can begin building a different type of home—whatever the market demands—almost immediately, while their counterparts in cities with zoning have to overcome obstacles.

"If there is a way to compensate for that higher mortgage cost by producing a lower cost house, the way you do that is by producing smaller homes on smaller lots—in other words, downsizing," said Dold. "The home builders and developing community of Houston reacted to higher interest rates by building and developing affordable homes almost immediately, but the builders in cities with zoning couldn't do that."

Subdivisions in the city have deed restrictions, said a Friendswood official, but the restrictions usually provide leeway on the size of a home and are not as restrictive as zoning ordinances. Deed restrictions are different for each subdivision.

According to Jack Byrd, vice president of Friendswood's residential division, zoning in most cases is a roadblock to marketing an affordable house.

"The time required to affect those changes is what the problem is," said Mike Brady, Friendswood's business planning manager. "It's not that developers and home builders in other parts of the country haven't identified those problems and aren't trying to work at it. It's just that they can't work as quickly and as effectively as the builders and developers in Houston can."

The minimum time to obtain approval for a variance in many zoned communities (Southern California, for example) is about three years.

This means that it may be as much as five years before a new product can be designed, approved and made available for sale.

By that time the market may well have changed again, with the seller incurring added costs as a result of this delay. Byrd continued. This makes it practically impossible for other cities and regions to respond to rapidly changing economic constraints.

One of the problems facing developers wanting to downsize homes in cities where zoning laws are in effect is that the developers are asking people who currently have homes to change the rules for others.

"Historically, they feel threatened," he said. "They think someone will build a smaller home next to theirs and make their property worth less."

The Friedswood hypothesis strikes a responsive chord in the home building industry here, with many industry leaders citing Houston's lack of zoning as a prime reason for the home building boom.

"Take Dallas, for example, a city that has zoning," said George H. Matters, president of U.S. Home Corp., the nation's largest on-site home constructor. "All of the suburbs also have zoning which restricts the size of a home to (a minimum of) 1,400 square feet."

During the recession, Matters continued, individuals couldn't afford to pay the high price tag of such a large home.

"Builders knew they had to offer smaller homes, but they couldn't because of the zoning restriction limiting a home to 1,400 square feet," he said.

Builders here could respond immediately to the market, Matters said, and home sales went through the roof.

The 1,400 square foot home requirement in Dallas means that the home must be built on minimum 60-foot-wide lots, said Brady.

"This means that $80,000 to $85,000 is the price of most of the available homes in the area, which effectively squeezes most first-time buyers out of the marketplace," he said.

For example, the buyer who pays 14½ percent fixed interest on a 30-year mortgage will pay $12.25 per month per $1,000 borrowed, exclusive of taxes, insurance, utilities—or about $1,200 a month on a $75,000 note, Brady said.

Assuming a lender requirement of a maximum 30 percent of monthly income for mortgage payments, the homeowner would have to have a combined household income of $48,000 per year to qualify for the same $75,000 note.

"This is especially difficult for the first-time buyer who has no equity to use for a down payment," he continued, "and even more difficult for a young couple 25 to 32 years old to earn a combined income of $48,000."

In Houston, the median housing cost for the first six months of 1982 was $73,000. In fact, about two-thirds of all new single-family homes in the city sold for less than $85,000 during this same period, Friendswood research shows.

One reason for the lower prices was smaller homes—not abodes where builders skimped on amenities, but units where rooms were smaller.

"The free-market significance becomes more obvious when there is a general downturn and people search for ways to sell homes," explained Brady. "That is when the builders and developers who are most responsive to changing market trends increase their market share."

The single-family housing boom hasn't gone bust, although the market for luxury high-rise condominiums in Houston has turned extremely soft. In addition, the city's office space market is overbuilt in most sections of town, and, until recently, apartment construction here was falling short of previous years.

"Housing is in transition because of increasing costs of home ownership, changing household formation and changing consumer perception of housing as an investment," said Dold. "Builders here have responded accordingly, and accordingly we see that home sales haven't declined but increased."

Senator TOWER. Thank you, Mr. Ehrle. We'll next hear from Mr. Robert Dillon, the vice president—I beg your pardon—Mr. Donald Hogan, representing the American Institute of Architects.

Mr. Hogan.

DONALD J. HOGAN, REPRESENTING AMERICAN INSTITUTE OF ARCHITECTS, SILVER SPRING, MD.

Mr. HOGAN. Thank you very much, Mr. Chairman. Mr. Tower and Mr. Riegle, my name is Don Hogan. I am a practicing architect and a partner in the architectural planning firm of Collins & Kronstadt-Leahy, Hogan, Collins, Draper, from Silver Spring, Md. The vast majority of my firm's work over the past 25 years has been in the field of housing.

I present these remarks today on behalf of the American Institute of Architects, which is the national organization for the architectural profession.

Accompanying me today is Mr. Albert Eisenberg, who is the director of government affairs for the institute.

The AIA thanks you for holding this hearing and for the opportunity for us to provide our viewpoints on housing costs.

In the context of today's hearing, of course, we are just coming out of the aftermath, we think, of one of the worst housing recessions in recent memory. And I don't think that we really have to expand, too much on the statistics that go into what that has meant. But, basically, even though January's figures show that housing is up 96 percent over a year ago, we still think that there's a long way to go and time will tell.

We do think that unless care is taken in the development of public policies and, in particular, economic policies, that we may get back on that rollercoaster again of up and down, as pent-up demand for housing is loosed on the market.

There are some ways that we think that housing costs can be reduced and that cost effectiveness of the Federal response to housing needs can be improved.

ECONOMIC RECOVERY THROUGH LOWER INTEREST RATES

First of all, we think that economic recovery through lower interest rates is very important. But we cannot have a sustained recovery unless monetary and fiscal policies are consistent and balanced. They must work in concert. And by that we mean that we would like to see a further reduction in interest rates by the Federal Reserve. And, on the other hand, we would like to see the projected budget deficit of close to $200 billion reduced.

We feel that that reduction probably cannot be made at the expense of housing, since housing has already taken the biggest single cut of any category on the budget.

The easing of those regulatory burdens, which are duplicative and unnecessary, are very crucial to the reduction of housing costs. Regulation entails delay and delays cost money.

Now many delays are not Federal delays. Many of them are related to local and State considerations. But I think that there are ways in which the Federal Government can help that and I'll refer to those later on.

In the chart I've brought along, on my right, we show the cost components that go into the make-up of a single-family residence. The biggest one, in red, of course, is materials. And the second, in the olive color, is the cost of land.

I think that land, just to take that for an example, has gone up perhaps more dramatically than most other costs. And there are lots of things that we can do to help there. We should encourage higher density along transportation routes and along routes where sewer and water and other infrastructure are already installed. And we should encourage zoning codes that adopt new and innovative techniques to get higher density, such as cluster housing, zero lot lines, and mixed use development.

ENCOURAGE STATEWIDE BUILDING CODES

In many States, as one of the previous witnesses has remarked, there are many different codes that are being used. And we find that this oftentimes leads to confusion. We applaud the efforts of States like Virginia and New Jersey, which have adopted statewide building codes. We, on the other hand, and just as an aside, don't recommend a national building code for the entire country. But we do encourage States to adopt building codes.

Housing rehabilitation, we think, poses a very special regulatory problem that adds to the burden of cost. The State of Massachusetts, however, has adopted provisions for a flexible code. And they estimate that, based on this code, housing costs for rehabilitation can be reduced by up to 5 percent.

What can the Government do to help? First of all, we think that the Federal Government can influence Federal, State, and local regulations by setting a good example and by encouraging performance-type standards rather than prescriptive standards.

Second, the Federal Government can take a leadership role in educating and encouraging local and State officials to establish uniform regulations.

One area that I have personal involvement in is the National Bureau of Standards fire safety evaluation system for hospitals and nursing homes. We recently designed some prototype housing for retarded citizens and we were working with our local fire marshal who was familiar with this system being worked on by the National Bureau of Standards. It helped to make our job a whole lot easier and I think, in the long run, saved a lot of money on the cost of the job. So we applaud that effort.

We think that the Federal Government, and only the Federal Government, can disseminate information on housing costs to the States. And, of course, the Federal Government can encourage and sponsor research into housing costs and ways to lower them. Some of this work has been going on at HUD. HUD has adopted an affordable housing program which is operating in 19 States to help streamline the regulatory process.

And in one demonstration project in California, they found that housing costs were lowered by reducing the regulatory process and also by increasing density anywhere from 10 to 20 percent of the basic cost of the housing.

Supply is another very definite consideration when you talk about housing. We're not beginning to meet the needs of the people. Some groups, such as the elderly, the poor, rural residents, must depend on strong Federal support for housing production and rehabilitation because the private sector simply isn't able to meet the needs in this area.

As section 8 is phased out and vouchers come in, we don't see that the vouchers will help the question of supply. They will certainly help the question of affordability, but not supply.

RECOMMENDATIONS

So, in conclusion, we at AIA have two recommendations. The first in which both the House and Senate Banking Committees deserve great credit, are multifamily rental rehabilitation and construction programs aimed at the problems of housing supply and housing quality.

While neither program was enacted, we understand that these proposals will most likely be reported by the Banking Committees once again. Both committees' proposals incorporate important concepts which should guide federal rental production programs in the future.

However, in reviewing the two measures, the AID feels that the House Banking Committee version, which is modeled on the successful UDAG program, offers the best program framework. This program provides funds that more nearly approach the need and permits greater flexibility in the local use of funds for new construction projects.

And finally, the AIA also wishes to state its opposition to certain administration recommendations for the community development block grant program. In short, they make little sense and will certainly do nothing to advance the cause of better housing in this country. The first proposal, to expand the CDBG program to include housing construction, would not add any new units, but would simply substitute new construction for rehabilitation. The second recommendation would blend the CDBG program with revenue sharing with the combined grant to be administered by the Treasury Department. The result would be a formless, directionless, mega-grant, in which the specific purposes of CDBG would be diluted and then overwhelmed. Placement of the mega-grant in the Treasury Department, rather than HUD, reveals its antihousing bias.

Thank you very much, Mr. Chairman. If there are any questions, I'd be glad to answer them.

[Complete statement of Mr. Hogan follows:]

A STATEMENT BY
DONALD J. HOGAN, AIA
on behalf of
THE AMERICAN INSTITUTE OF ARCHITECTS

Mr. Chairman, and members of the Subcommittee, my name is Donald J. Hogan, AIA. I am a practicing architect from Potomac, Maryland, and a member of the firm of Collins & Kronstadt-Leahy, Hogan, Collins, Draper in Silver Spring, Maryland. The vast majority of my firm's work is in the housing area, with special attention given to the impact and development of housing market policies in the United States.

I present these remarks on behalf of the American Institute of Architects, the national association which represents the architectural profession. Accompanying me today are David Olan Meeker Jr., FAIA, Executive Vice-President of the AIA, and Albert C. Eisenberg, Director of Government Affairs.

The AIA thanks you for holding this hearing, and for the opportunity you have provided us to offer our views on housing costs. We applaud your efforts and those of the Subcommittee and its staff to make housing more affordable and to improve the cost-effectiveness of federal programs and regulations, particularly during this time of severe budget limitations.

By way of personal background, I would like to note that I have helped design over 150,000 housing units across the country, including single and multi-family dwellings. In 1979 and 1980, I was an advisor on HUD's "Building Value into Housing Grant Program" and its "Residential Building Technology Innovations Program." I presented the AIA's testimony on housing costs to the

President's Commission on Housing in 1981, and I am also a former chairman of the AIA's housing committee, which was established before World War II, and which develops the Institute's policies on housing.

If the subcommittee would approve, I would like to make a brief statement, and then submit for the hearing record a more detailed discussion of ways to improve housing regulations in order to reduce housing costs.

Today's hearing occurs in the context of one of the worst housing depressions ever. In the past year, production fell more than 50 percent behind the need, and unemployment among construction workers reached above 20 percent. While it appears that this depression has bottomed out, with housing starts for January 1983 96 percent ahead of a year ago, the road back will be long and filled with obstacles. Mortgage interest rates have come down dramatically since 1981, but remain at historically high levels of 12½ to 13 percent. Housing prices have also leveled off, and have even declined a bit as purchases all but dried up during 1982. However, prices are still too high for the overwhelming number of American families. The median new house price in January 1983 moved up to $75,500. As interest rates and high prices have squeezed out millions from the housing market, the general recession and intolerably high unemployment have driven off millions more who would have entered the market under better economic conditions. Yet the underlying demand and need for housing are great and will grow. Unless care is taken in the development of public policies, particularly economic policies, the stage will be set for another ruinous roller coaster ride for the housing industry, as pent-up demand is let loose on a market that has fallen way behind in its ability to provide affordable housing.

Let me suggest several ways to reduce housing costs and to improve the cost effectiveness of the federal response to housing needs.

Economic recovery through lower interest rates is of course paramount, but we cannot assure a sustained recovery unless monetary and fiscal policies are more consistent and balanced. The two must work in concert. The Federal Reserve should ease monetary restrictions still further to bring down interest rates. As lower interest rates have their desired economic effect, the federal budget deficit must be brought down from their $200 billion annual level to make sure that federal borrowing does not overwhelm private borrowing needs, choking off the recovery at its birth. And in lowering these deficits, housing should no longer be expected to absorb any further cutbacks, having already suffered the largest cuts of any single domestic program area.

The easing of regulatory burdens is absolutely crucial to the reduction of housing costs. Regulation entails delay and delay costs money. This committee and the Administration deserve credit for focusing attention on this important policy area. Although it is difficult to estimate how various government regulation adds to the cost of a house, we know it does impose costs because it impinges on every stage of the development and construction process.

In the chart I have brought along, I have shown the cost components of a new single family home. I think that reductions in regulations can affect almost all these components. I have also brought some architectural drawings indicating that cost control need have no effect on housing quality or attractiveness of design.

Let's take land for example. Included in land costs are not just the cost of the raw land, but also the cost of site clearance and preparation and the services necessary to make the land usable. To lower land costs, we should eliminate overlapping environmental impact studies. We should encourage higher density along transportation routes and where existing sewer and water services are already available. Zoning codes should incorporate the latest planning concepts to allow cluster housing, mixed-use development, and zero lot line development, all of which use less land and allow shorter utility runs.

In many states, conflicting codes from locality to locality, and even within communities, have caused confusion and added unnecessary steps to the construction process. Fire marshals, for instance, use the National Fire Protection Association standards in their fire and safety inspections, even though their localities may have adopted a building code developed by one of the model code organization. This conflict requires the architect to compare the codes and then apply the most stringent standards where differences exist. State-wide or regional building codes can significantly reduce the confusion and delay, and thus can lower costs. New Jersey and Virginia are two states which have adopted state-wide building codes with good results.

Housing rehabilitation often poses special regulatory problems. In most jurisdictions, those undertaking rehabilitation find themselves faced with the dilemma of how to upgrade existing structures to comply with building codes that are primarily designed for new buildings. Full compliance usually means prohibitive costs. Thus the developer must appeal those provisions of the code which he cannot meet, a process that is time consuming and expensive as well. The state of Massachusetts, which has remedied its problem by establishing flexible code provisions, estimates that this type of code conflict can add five percent to the cost of a house.

Conflicting regulations are not the only source of delays. Inertia and unnecessary paperwork requirements are common problems. Government departments with jurisdiction over the construction process should try to facilitate, rather than hamper, desired construction. Continuous process reviews and evaluations to locate the sources of delay must be essential management functions of these departments. A promising activity to reduce delay is underway by the National Conference of States on Building Codes and Standards with their efforts to develop a model streamlined permit process for residential structures.

The federal government can influence state and local regulation by setting an example. It can put its own regulatory house in order and has made some important progress in doing so. With respect to its construction regulations, it can put forth performance rather than prescriptive standards. Regulations should be more concerned with assuring a desired outcome rather than prescribing the specific means for attaining it. This would permit more flexibility in applying latest technology and construction methods, saving time and money. It would also encourage greater innovation among those in the building industry.

The federal government can take a leadership role in educating and encouraging local and state officials to establish uniform regulations. One example is the National Bureau of Standards Fire Safety Evaluation System for hospitals and nursing homes. NBS has set up this system so that a uniform level of fire safety can be obtained by a variety of methods, rather than through compliance with a prescriptive code.

Dissemination of federal studies on housing costs is another way for the federal government to have an effect on state and local regulation. Excellent studies exist such as the HUD Task Force on Housing Costs of 1978, the HUD National Conference on Housing Costs of 1979, and the report "Reducing the Development Cost of Housing: Actions for State and Local Governments." The Report of the President's Commission on Housing also provides many worthwhile recommendations on streamlining regulations. The AIA and other organizations can provide assistance with publication or dissemination of this information to their members, in cooperation with HUD or other agencies.

Of course, research into housing costs, and ways to lower them, must continue on the federal level, and this subcommittee can ensure that HUD's Policy Development and Research Office pays appropriate attention to this subject.

HUD's "Affordable Housing Program" which operates in nineteen localities, brings developers and local officials together to find ways to streamline the regulatory process. Preliminary findings indicate that on a house originally costing in the $40,000-50,000 range, $5,000-10,000 in savings can be realized due to the kinds of activities featured in the program. This subcommittee should take steps to ensure that HUD completes this demonstration program to see if the preliminary findings hold up over time, and to broaden the study to include in-fill and rehabilitation housing in urban areas.

No discussion of housing costs is complete without considering the subject of housing supply. Here I would like to relate my remarks most directly to housing authorization legislation. Adequacy of supply is closely linked to prices and rent levels in any given market. It is clear that housing preservation and new production are sorely needed. Estimates of annual additional housing need range from about 2 million to 2.5 million units. Many forecasters project that the annual shortfall during the 1980's will average 1.25-1.5 million units, even with economic recovery. The multi-family housing sector will suffer a shortfall of more than 300,000 units a year, through the decade, according to figures developed in HUD in 1980, and this estimate assumes a level of 150,000 units a year of federally-subsidized housing. In addition to lack of housing production, the nation suffers losses of about 600,000 units from the stock for various reasons, including abandonment, deterioration, fire, and demolition. HUD's own recommendations to OMB for FY 1984 acknowledge supply problems in some housing markets. Some groups, such as rural residents, renters, and the poor, must depend upon strong federal support for housing production and rehabilitation, because the private sector has not shown an ability to meet their needs unaided. While the Section 8 program has since 1975 constituted a large portion of federally-assisted construction, it is clear that the program's enormous costs have made it inappropriate to maintain. Unfortunately, no new construction program has been enacted to replace Section 8.

In comparison to prior program levels and to the need, the Administration housing program for FY 1984 virtually abandons any interest in federally-assisted new construction and substantial rehabilitation. The Section 8 and public housing construction program should terminate under the Administration's proposals to be replaced by a program of existing housing "vouchers." At the same time, the Administration would cancel funding for almost 68,000 Section 8 and public housing units already planned for construciton. This cancellation will offset any funds the Administration wants to allocate for other housing production and rehabilitation. Vouchers or existing housing assistance address only affordability problems, not those of supply.

Both House and Senate Banking Committees deserve great credit for approving last year multi-family rental rehabilitation and construction programs aimed at the problems of housing supply and housing quality. While neither program was enacted, we understand that these proposals will most likely be reported by the Banking Committees once again.

Both Committees' proposals incorporate important concepts that should guide federal rental production programs in the future. These concepts include the separation of production subsidies from rental subsidies, flexibility in local and state use of funds, close involvement of the private sector in the proposed programs, short-term federal obligations, opportunity for recapture of the production subsidies, and development of mixed-income housing.

However, in reviewing the two measures, the AIA feels that the House Banking Committee version, which is modeled on the successful UDAG program, offers the best program framework. This program provides funds that more nearly approach the need, and permits greater flexibility in the local use of funds for new construction projects.

The AIA also wishes to state its opposition to certain Administration recommendations for the Community Development Block Grant (CDBG) program. In short, they make little sense, and will certainly do nothing to advance the cause of better housing or neighborhood conditions in this country. The first proposal, to expand the CDBG program to include housing construction would not add any new units, but would simply substitute new construction for rehabilitation. The second recommendation would blend the CDBG program with revenue sharing, with the combined grant to be administered by the Treasury Department. The result would be a formless, directionless mega-grant in which the specific purposes of CDBG would be diluted and then overwhelmed. Placement of the mega-grant in the Treasury Department, rather than HUD, reveals its anti-housing bias.

Mr. Chairman, this concludes my testimony. I would be happy to answer any questions you or other Senators may have.

Senator Tower. Thank you, Mr. Hogan. Our next witness is Mr. Robert Dillon, the vice president of the National Institute of Building Sciences.

Mr. Dillon.

ROBERT M. DILLON, VICE PRESIDENT, NATIONAL INSTITUTE OF BUILDING SCIENCES, WASHINGTON, D.C.

Mr. Dillon. Mr. Chairman, Senator Riegle, I'm also an architect. The National Institute of Building Sciences is a private, nonprofit corporation that was authorized by the Congress in 1974. And in the words of that legislation, the Institute is charged with making findings and advising both the public and private sectors of the economy with respect to the use of building science and technology in achieving acceptable criteria, standards, and other technical provisions for use in Federal, State, and local housing and building regulations.

In essence, the mission of the Institute is to bring about a more rational housing, building and land development regulatory environment throughout the United States.

Given the fact that the HUD-FHA minimum property standards have been and are such a major factor in the housing regulatory environment in the United States, and given the fact that the Institute played such a major role in the move to phase out the MPS, it seems particulary appropriate that we be here today to address the future course of events regarding the MPS.

And let me begin this statement by saying that the Institute has the highest regard for the role both the Federal Housing Administration and the MPS have played in enabling the United States to become perhaps the best housed nation in the world.

Therefore, what the Institute has recommended and what I say here today is in no way intended to detract from that record of achievement.

However, conditions do change.

On April 15, 1981, in a report entitled "Federal Regulations Impacting Housing and Land Development: Recommendations for Change," the Institute recommended that:

INSTITUTE RECOMMENDATIONS

"HUD should initiate a comprehensive and rational process to phase out the MPS for HUD-insured housing and rely on the nationally recognized model codes, and on State and/or local authorities that have adopted such codes or that have their equivalent, to regulate the health and safety aspects of such housing, and on free market forces to establish acceptable performance levels for livability and marketability of such housing. HUD should propose a specific program and time schedule for achieving these objectives. As a first step in this process, HUD should release its pending 1980 one- and two-family MPS, which represent a reduction and simplification of requirements."

The Institute then suggested "one way in which such a comprehensive process might be implemented," and I have attached the full text of this recommendation and supporting information.

It is interesting to note that recommendations of a similar nature were made by the President's Task Force on Regulatory Relief and the President's Commission on Housing, both of which were aware of and had been briefed on the Institute's regulatory studies.

The underlying reason for the Institute's recommendation was the desire to strengthen the cause of regulatory harmonization; that is, to do all possible to reduce the needless and debilitating overlap, duplication, and conflict in housing, building, and land development regulation at the Federal, State, and local levels of government.

Something has to give if rationality is to be introduced into the current chaos that is today's housing and building regulatory environment. Traditionally and constitutionally, the police powers have rested with the States, and the regulation of housing and building have been viewed as an exercise of the police power.

To be sure, the interstate commerce clause has been brought into play as a rationale for regulating certain products moving in interstate commerce, including the mobile home; however, the prevailing opinion has been, and continues to be, to support State and/or local over Federal regulation of housing and building.

If this is a fair assessment of the national will, then it seems logical that the MPS, as a form of Federal regulation, give way to State and local regulation. However, the simple supplanting of one for the other would not be a satisfactory solution. The cause of regulatory harmonization will not be served by giving up the unifying effect of the MPS for a return to reliance on the estimated 14,000 to 25,000 separate, local regulatory jurisdictions. This is why the Institute also has recommended support of the nation's voluntary standards system and the nationally recognized model code system.

If the States, and local units of government that have been granted regulatory powers by the States, will adopt one of the nationally recognized model codes, including the model One- and Two-Family Dwelling Code that has been adopted by reference in the three most prominent of these codes, a great deal could be accomplished toward the goal of harmonization of regulatory requirements.

Then, if even more effective bridges can be fashioned between the model codes and the voluntary standards system, additional improvements can be realized in the total system. It then would remain to strengthen the voluntary standards and model code systems themselves.

And it is in this latter effort that the Institute sees a continuing role for the Federal Government, and in the specific case of housing, for the Federal Housing Administration, Veterans' Administration, and Farmers Home Administration.

The Institute has recommended Federal support of, participation in, and reliance on, the voluntary standards system, and this seems to be coming to pass with the issuance of the revised OMB Circular A-119. The Institute has also recommended that FHA participate in, and rely on, the model code system.

Specifically, it has recommended that FHA participate in the Council of American Building Officials code change process which is intended to upgrade and maintain the CABO One- and Two-

Family Dwelling Code, and then support the code by recognizing it for the protection of health and safety and adopting it by reference as the basis for determining the adequacy of State and local codes and for use in areas where no code has been duly adopted.

In a similar vein, the Institute recommended that HUD recognize any of the nationally recognized model building codes for the protection of health and safety in HUD-insured multi-family housing.

Insofar as livability and marketability features are concerned, the Institute recommended that HUD, in cooperation with the private sector, develop consumer-oriented guide criteria and, beginning with one- and two-family housing, conduct a 3-year experiment with the assistance of the mortgage finance industry that will allow voluntary use of the criteria to determine the extent to which free market forces can be relied upon to protect FHA's insurance risk and to provide quality acceptable to consumers.

The Institute's recommendation recognized that HUD had already taken certain actions to reduce and simplify the MPS for one- and two-family dwellings, and as noted, HUD subsequently issue the 1980 One- and Two-Family MPS. Beyond that, HUD has not followed the Institute's recommendation to the letter; this the Institute did not expect. However, the recommendation called upon HUD to propose a specific program and time schedule, and this it has done. Also, it has been participating in the CABO One- and Two-Family Dwelling Code code change process. And now, it has published proposed revisions to the MPS for Multi-Family Housing. However, although the phasing-out process is moying along at a good pace, to our knowledge, HUD has not yet begun the development of guide criteria for the livability and marketability aspects of housing performance.

The Institute would like to clarify several points and suggest a caution or two. First, the Institute addressed only HUD-insured housing, not subsidized housing. Therefore, we are not prepared to comment on any extension of the phasing out effort into subsidized housing, where the consumer has a lesser opportunity to exercise freedom of choice.

The Institute did not employ the term "durability" as distinct from "health and safety" or "livability and marketability." It is our view that durability is a parameter in both of these critical aspects of housing.

Finally, as has been alluded to, the Institute definitely would not favor any move to phase out the MPS in favor of State and/or local codes per se. Such a move would be counter to the ultimate objective of achieving greater harmonization of regulatory requirements.

Indeed, it was recognition of the fact that FHA has been so successful in stimulating private sector responses to market demands and that voluntary standards and model code organizations have been as successful as they have been in creating an improved scientific and technical base for housing regulation, that led the Institute to recommend that FHA use its demonstrated leadership to encourage the voluntary standards and model codes movement rather than simply step aside.

It must be recognized that this goal cannot be achieved overnight.

In conclusion, then, it would be our hope and recommendation that the phasing-out operation continue apace, but that neither the consumer's interests, the Government's financial risks, nor the ultimate objective of a more healthy regulatory environment be lost sight of. The Institute stands ready to help in any way it can.

Thank you, Mr. Chairman.

[Complete statement of Mr. Dillon follows:]

STATEMENT BY

ROBERT M. DILLON, AIA, M.ASCE
VICE PRESIDENT

NATIONAL INSTITUTE OF BUILDING SCIENCES

Mr. Chairman and members of the Subcommittee, my name is Robert M. Dillon. I am an architect and Vice President of the National Institute of Building Sciences. The Institute is a private, nonprofit corporation authorized by the Congress in 1974 (Section 809 of Public Law 93-383) and charged with making findings and advising both the public and private sectors of the economy with respect to the use of building science and technology in achieving nationally acceptable criteria, standards, and other technical provisions for use in Federal, State, and local housing and building regulations. In essence, the mission of the Institute is to bring about a more rational housing, building and land development regulatory environment throughout the United States.

Given the fact that the HUD-FHA Minimum Property Standards (MPS) have been and are such a major factor in the housing regulatory environment in the United States, and given the fact that the Institute played such a major role in the move to phase-out the MPS, it seems particularly appropriate that we be here today to address the future course of events regarding the MPS.

Let me begin this statement by saying that the Institute has the highest regard for the role the Federal Housing Administration and the MPS have played in enabling the United States to become perhaps the best housed nation in the world. Therefore, what the Institute has recommended and what I say here today is in no way intended to detract from that record of achievement. However, conditions do change.

In an April 15, 1981, report entitled, Federal Regulations Impacting Housing and Land Development: Recommendations for Change, the Institute stated:

> "HUD should initiate a comprehensive and rational process to phase out the MPS for HUD-insured housing, and rely on the nationally recognized model codes, and on State and/or local authorities that have adopted such codes or that have their equivalent, to regulate the health and safety aspects of such housing, and on free market forces to establish acceptable performance levels for livability and marketability of such housing. HUD should propose a specific program and time schedule for achieving these objectives. As a first step in this process, HUD should release its pending 1980 One- and Two-Family MPS, which represent a reduction and simplification of requirements."

The Institute then suggested, "one way in which such a comprehensive process might be implemented....1/"

It is interesting to note that recommendations similar to those of the Institute were made by the President's Task Force on Regulatory Relief and the President's Commission on Housing, both of which were aware of, and had been briefed on, the Institute's regulatory studies.

The underlying reason for the Institute's recommendation was the desire to strengthen the cause of regulatory harmonization--i.e., to do all possible to reduce the needless and debilitating overlap, duplication, and conflict in housing, building, and land development regulation at the Federal, State, and local levels of government. Something has to give if rationality is to be introduced into the current chaos that is today's housing and building regulatory environment. Traditionally and constitutionally, the police powers have rested with the States, and the regulation of housing and building have been

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1/ The full text of the recommendation and supporting information is attached.

viewed as an exercise of the police power. To be sure, the interstate commerce clause has been brought into play as a rationale for regulating certain products moving in interstate commerce, including the mobile home; however, the prevailing opinion has been and continues to be to support State and/or local over Federal regulation of housing and building. If this is a fair assessment of the national will, then it seems logical that the MPS, as a form of Federal regulation, give way to State and local regulation. However, the simple supplanting of one for the other would not be a satisfactory solution. The cause of regulatory harmonization will not be served by giving up the unifying effort of the MPS for a return to reliance on the estimated 14,000 to 25,000 separate, local regulatory jurisdictions. This is why the Institute also has recommended support of the nation's voluntary standards system and the nationally recognized model code system.

If the States, and local units of government that have been granted regulatory powers by the States, will adopt one of the nationally recognized model codes, including the model One- and Two-Family Dwelling Code that has been adopted by reference in the three most prominent of these codes, a great deal could be accomplished toward the goal of harmonization of regulatory requirements. Then, if even more effective bridges can be fashioned between the model codes and the voluntary standards system, additional improvements can be realized in the total system. It then would remain to strengthen the voluntary standards and model code systems themselves. And it is in this latter effort that the Institute sees a continuing role for the Federal Government, and in the specific case of housing, for the Federal Housing Administration, Veterans Administration, and Farmers Home Administration.

The Institute has recommended Federal support of, participation in, and reliance on, the voluntary standards system, and this seems to be coming to pass with the issuance of the revised OMB Circular A-119. The Institute also has recommended that FHA participate in, and rely on, the model code system. Specifically, it has recommended that FHA participate in the Council of American Building Officials code change process which is intended to upgrade and maintain the CABO One- and Two-Family Dwelling Code, and then support that code by recognizing it for the protection of health and safety and adopting it by reference as the basis for determining the adequacy of State and local codes and for use in areas where no code has been duly adopted. In a similar vein, the Institute recommended that HUD recognize any of the nationally recognized model building codes for the protection of health and safety in HUD-insured multi-family housing.

Insofar as livability and marketability features are concerned, the Institute recommended that HUD in cooperation with the private sector, develop consumer oriented guide criteria and, beginning with one- and two-family housing, conduct a three-year experiment with the assistance of the mortgage finance industry that will allow voluntary use of the criteria to determine the extent to which free market forces can be relied upon to protect FHA's insurance risk and to provide quality acceptable to consumers.

The Institute's recommendation recognized that HUD had already taken certain actions to reduce and simplify the MPS for one- and two-family dwellings. However, beyond that, HUD has not followed the Institute's recommendation to the letter; this, the Institute did not expect. The recommendations called upon HUD to propose a specific program and time schedule, and this it has done. As noted, it issued the 1980 One- and Two-Family MPS. It has been participating in the CABO One- and Two-Family

Dwelling Code code change process. And, now, it has published proposed revisions to the MPS for Multi-Family Housing. And, although the phasing-out process is moving along at a good pace, to our knowledge, HUD has not yet begun the development of guide criteria for the livability and marketability aspects of housing performance.

The Institute would like to clarify several points and suggest a caution or two. First, the Institute addressed only HUD-insured housing, not subsized housing. Therefore, we are not prepared to comment on any extension of the phasing out effort into other than insured housing, where the consumer has a much greater opportunity to exercise freedom of choice.

The Institute did not employ the term durability as distinct from "health and safety" or "livability and marketability." It is our view that durability is a parameter in both of these critical aspects of housing.

Finally, as has been alluded to, the Institute definitely would not favor any move to phase out the MPS in favor of State and/or local codes per se. Such a move would be counter to the ultimate objective of achieving greater harmonization of regulatory requirements. Indeed, it was recognition of the fact that FHA has been so successful in stimulating private sector responses to market demands and that voluntary standards and model code organizations have been so successful as they have been in creating an improved scientific and technical base for housing regulation, that led the Institute to recommend that FHA use its demonstrated leadership to encourage the voluntary standards and model codes movement rather than simply step aside. It must be recognized that this goal cannot be achieved overnight.

In conclusion then, it would be our hope and recommendation that the phasing-out operation continue apace but that neither the consumer's interests, the government's financial risks, nor the ultimate objective of a more healthy regulatory environment, be lost sight of. The Institute stands ready to help in this in any way it can.

Thank you Mr. Chairman. I will be happy to answer any questions you may have.

NATIONAL INSTITUTE OF BUILDING SCIENCES

Washington, D.C.

April 15, 1981

FEDERAL REGULATIONS

IMPACTING HOUSING AND LAND DEVELOPMENT:

RECOMMENDATIONS FOR CHANGE

1.0 HUD MINIMUM PROPERTY STANDARDS (MPS)

1.1 Recommendation

HUD should initiate a comprehensive and rational process to phase out the MPS for HUD-insured housing, and rely on the nationally recognized model codes, and on State and/or local authorities that have adopted such codes or that have their equivalent, to regulate the health and safety aspects of such housing, and on free market forces to establish acceptable performance levels for livability and marketability of such housing. HUD should propose a specific program and time schedule for achieving these objectives. As a first step in this process, HUD should release its pending 1980 One- and Two-Family MPS, which represent a reduction and simplification of requirements.

One way in which such a comprehensive process might be implemented would be for:

a. HUD to set a certain date--e.g., June 30. 1983--as the date on which it will recognize the model One- and Two-Family Dwelling Code which has been developed by State and local officials for the protection of health and safety (and which will have been revised by that time, utilizing research that has been accomplished by the National Association of Home Builders Research Foundation and HUD). Once recognized, the model One- and Two-Family Dwelling Code would become the document HUD would adopt by reference and then would use to measure substantial equivalency of existing State and local codes, and use in areas where no code exists.

b. HUD to set a certain date--e.g., December 1, 1981, as the date on which it will recognize any of the nationally recognized model building codes for the protection of health and safety in HUD-insured multi-family housing. Once recognized, the nationally recognized model building code appropriate to the area would become the document HUD would adopt by reference and then would use to measure substantial equivalency of existing State and local codes in that area, and use where no code exists in that area.

c. HUD to participate actively in the code-change processes of the nationally recognized model code bodies by submitting suggested changes, engaging in the open-code-change meetings, and assisting in any needed research to resolve technical issues.

d. HUD to accept, as adequate for health and safety, the plan-checking and inspection of any State or community that has adopted without change and adequately enforces the model One- and Two-Family Dwelling Code and/or one of the nationally recognized model building codes for multi-family housing, or that has and adequately enforces a code or codes of equivalent provisions, including any State or community that accepts certification of code compliance by State-registered architects and engineers in their areas of cognizance as established by State law.

e. HUD to develop and issue consumer-oriented guide criteria for the livability and marketability aspects (i.e., non-code aspects) of housing performance and, beginning with one- and two-family housing, to conduct a three-year experiment, with the assistance of the mortgage finance industry, that will allow voluntary use of the criteria to determine the extent to which free market forces will protect HUD's insurance risk and provide quality acceptable to consumers at the various income levels involved. (This should be done with a view to phasing-out these aspects of the MPS for one- and two-family dwellings and, subsequently, the MPS for HUD-insured multi-family housing as well.)

f. HUD to continue its product certification program in consonance with the above, but to work with the National Institute of Building Sciences to evolve a nationwide system for materials, products, and systems certification that can replace that program and be relied on by State and local authorities.

g. The Veterans Administration (VA), the Farmers Home Administration (FmHA), and HUD to: implement this program uniformly under existing provisions of law and existing memoranda of understanding or, if necessary, revisions thereto; and assist in achieving the program objectives outlined herein.

Because the MPS are not a requirement of law, alternative means of achieving the same ends can be adopted by HUD regulation after public notice and comment. No statutory revision is necessary.

1.2 Background

The HUD MPS originally were adopted in 1935 pursuant to the National Housing Act of 1934 (Pub. L. No. 73-479, 48 Stat. 1246, 12 U.S.C., Sec. 1701, et. seq.) which authorized HUD (then the Federal Housing Administration) to insure mortgages that meet certain requirements. However, there is no explicit provision mandating the issuance of the MPS.

In adopting the MPS, HUD and its predecessor agencies relied on the general authority of the Act. For example, under section 203(a), HUD is authorized to insure certain mortgages for single-family homes (including structures for two to four families) "upon such terms as the Secretary may prescribe." Section 203(c) requires the Secretary to find "that the project with respect to which the mortgage is executed is economically sound" and applies to multi-family rental project mortgages insured under Section 207 as well as single-family home mortgages. Programs for insuring low-income property mortgages have different requirements but also provide general authority for the MPS. For example, Section 221(f) specifies that "the property or project shall comply with such standards and conditions as the Secretary may prescribe to establish the acceptability of such property for mortgage insurance."

The Housing Act of 1937, as amended by the Housing Community Development Act of 1974 (Pub. L. No. 93-383, 88 Stat. 633, 42 U.S.C., Sec. 1401, et seq.), defines "low-income housing" as "decent, safe and sanitary dwellings within the financial reach of families of low income...." Under the public housing program, HUD makes contributions to public housing authorities to cover prototype costs for the construction of low-income housing. These costs must be set with reference to "various type and sizes" of units "suitable" for the assisted families, taking into account safety, health, economy, energy conservation, neighborhood architectural standards, and other factors. Again, nothing in the Act requires promulgation of the MPS (24 C.F.R., Sec. 200.931). Units constructed and assisted under section 8 of the Act also must be "suitable" for the families assisted and meet the "decent, safe and sanitary" criteria. New construction standards are not otherwise mandated.

Thus, it is clear that HUD is charged to promote the production of housing of sound design and construction that has livability and size characteristics adequate for family life. The MPS are an expression of this charge and an administrative device for pursuing these ends.

The MPS originally were titled Minimum Property Requirements. In 1974, following public notice and comment, the MPS were first incorporated in HUD regulations. The extant MPS, published in handbook form (Minimum Property Standards for One- and Two-Family Dwellings 4900.1, Minimum Property Standards for Multi-Family Housing 4910.1, and Minimum Property Standards for Care-Type Housing 4920.1), now are incorporated by reference in 24 C.F.R., Sec. 200, Subpart S. Additionally, Intermediate Minimum Property Standards for Solar Heating and Domestic Hot Water Systems (SIMPS) are referenced in 24 C.F.R., Sec. 200, Subpart S, Sec. 4930.2. Also, qualification procedures for the HUD building products certification program, including material standards, accepted engineering practice standards, site development standards, and miscellaneous references to regulations of other agencies and publications of private groups dealing with standards and testing, are referenced in 24 C.F.R., Sec. 200.935. According to 24 C.F.R., Sec. 200.925, "all housing constructed under HUD mortgage insurance and low-rent public housing programs shall meet or exceed the HUD Minimum Property Standards."

The revised one- and two-family housing MPS were published in proposed form in September 1980 (Fed. Reg. 62316). The revision eliminates most criteria that do not bear directly on health, life safety, statutory requirements, or durability, but it currently is being held in abeyance, pending a decision to issue.

Finally, Section 905 of the Housing Act of 1978 provides for use of the HUD MPS by the FmHA (7 C.F.R., Sec. 1804.2(d)). Section 26.4347, 38 C.F.R. gives the VA Administrator the authority to set minimum property standards, and memoranda of understanding between these agencies have been entered into to harmonize their respective requirements.

1.3 Issue and Justification

When the Federal Housing Administration (FHA) was created in 1934, there was a dire need to demonstrate that long-term mortgages on housing for low- and moderate-income families were a prudent investment. To achieve this objective, FHA believed it necessary to ensure that the properties it underwrote would, in fact, be durable and marketable as well as safe and sanitary. The resale of many FHA homes, often under private financing, has amply demonstrated the success of the FHA in achieving this basic objective.

It also must be recognized that during the first 20 to 25 years of FHA's existence, a large portion of housing--particularly one- and two-family housing--was not regulated at the local level, particularly in the rapidly expanding suburban areas of the nation's cities. Only recently have there been major gains in the development and promulgation of model codes for one- and two-family housing and in the upgrading of code enforcement capabilities. Indeed, even today there are suburban and rural areas that have no codes for the regulation of the health and safety aspects of housing and/or lack the range of expertise needed to enforce such codes. Thus, until quite recently there has not been an adequate foundation on which to build a program for shifting the leadership role in housing standards that the FHA has so ably filled since the early 1930s.

Today, however, there are private mortgage insurance organizations, model codes for both multi-family and one- and two-family housing, State and local regulatory bodies of increasing effectiveness, and a more universal understanding and acceptance of market forces in the regulation of livability and marketability. The issue, therefore, is whether the time has come for HUD (FHA) to phase out its MPS and attendant materials, products and systems certification and inspection activities and to rely on State and local governments and the market to perform these functions. The MPS unquestionably have had a powerful and positive influence on home ownership and the quality of housing in the United States and are still the premier documents in the field. Nevertheless, if the FHA were to put its expertise behind the needed improvements in State and local regulatory processes and private voluntary standards and certification activities, not only would all of housing be well served but overlapping regulations and inspections could be eliminated as well. This same effort would strengthen the cause of regulatory uniformity. If such a change in direction is not made, the continuing decline in HUD's insurance activity--particularly mortgage insurance for one- and two-family dwellings--might deprive the Nation of the opportunity to build on the achievements of the MPS.

Although the immediate significance of such a change in HUD's role may not be great in dollar terms, it would stimulate a movement already begun by HUD and would contribute to significant cost-effectiveness gains in the long run by eliminating duplication and speeding the approval process. The transformation, however, cannot be accomplished overnight. Many States and communities have not adopted the model One- and Two-Family Dwelling Code promulgated by the Council of American Building Officials (CABO) or one of the nationally recognized model building codes (BOCA, ICBO, SBCC), and certainly very few have done so without modification. Many States and communities also lack enforcement capability, and there is no fully recognized materials, products, and systems certification program yet in place. Conversely, there are areas—particularly in big cities--where there are sound codes, sound enforcement, and good product approval systems. Nevertheless, even though both extremes exist, the process can begin and HUD should propose its own program and time schedule for doing so. There need be no gaps in either HUD or consumer protection.

It is paramount, however, that HUD not seek to dominate the process of change; rather, it should assist as it withdraws from the field. This should be made clear in any Executive Order or executive action that is taken to implement this recommendation. It is equally important that the provisions of law and memoranda of understanding dealing with uniformity of requirements between VA, FmHA, and HUD be made to apply at each step in the recommended phasing-out process, to the end that there will be uniformity of housing requirements and processing among these three key Federal agencies.

Senator TOWER. Thank you very much, Mr. Dillon. Our next witness is Mr. Robert Georgine, the president of the Building and Construction Trades Department of the AFL-CIO.

Mr. Georgine.

STATEMENT OF ROBERT A. GEORGINE, PRESIDENT, BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL-CIO, WASHINGTON, D.C.

Mr. GEORGINE. Mr. Chairman, members of the subcommitee, thank you very much for inviting me to appear before the committee to testify about housing costs.

I am president of the Building and Construction Trades Department of the AFL-CIO, which is composed of 15 affiliated national and interantional unions representing approximately 4 million construction workers, who live and work in communities throughout the United States.

I have appeared before this committee on a number of previous occasions concerning specific legislative proposals. While the committee currently has before it the administration bill, S. 644, the Housing and Community Development Act of 1983, it is my understanding that your panel testimony is to be addressed to housing costs generally and not with respect to any particular legislative proposals.

Senator TOWER. That doesn't foreclose your commenting on any of it, Mr. Georgine. But, of course, our primary interest is really trying to get some understanding of what we might be able to do to bring housing costs down. That's the bottom line.

But, obviously, you are free to comment on any relevant legislation.

Mr. GEORGINE. OK. Thank you, Mr. Chairman. I think what I will do is I would submit for the record some comments about the bill itself.

The housing construction industry today continues in great economic difficulties.

As you well know, the last several years have been of Depression era dimensions for this industry. Housing starts have been at a 40-year low. And I must say that from what I heard this morning in the testimony of Secretary Pierce, I'm not too optimistic about the immediate future.

But while some improvement has taken place in recent months, the road back will be long and painful. In terms of the workers that I represent, the result of this depressed situation is a continuing high level of unemployment. Compounded for those still working is the large shortage of affordable housing with very high mortgage interest rates.

THE DAVIS-BACON ACT

My focus this afternoon is on the question of labor cost and particularly, the impact of prevailing wage protections, that is, the Davis-Bacon Act, on certain federally assisted housing construction.

We have been through this exercise before in this committee on the very same subject many times, Mr. Chairman. There are half a million contractors in the American construction industry. It's one of the last areas where an American worker can become an independent business owner through the skill of his hands and the drive of his ambitions.

Now through the years, many, many members of the unions affiliated with the Building and Construction Trades Department have become substantial businessmen. We're proud of them and of the spirit of free enterprise that they typify.

One reason for their ability to advance themselves has been the Davis-Bacon Act. It has operated as a shield against the abuses of predatory contractor sharks who, prior to enactment of the Davis-Bacon, fleeced the Federal Government and the taxpayers, exploited their work force, and brought misery to the communities that Federal efforts were supposed to help.

Since it was signed into law by President Hoover in 1931, the Davis-Bacon Act has worked to require honest bids on Government contracts. It has protected honest contractors from carpetbagging sharpies who would bid on the basis of less than prevailing wage rates in the area and then use the control of project jobs to drive wages down.

It has put a premium on good work and management in the American free enterprise tradition.

The Davis-Bacon Act is intended to prevent Federal or federally supported construction from being used as a vehicle to drive down wages prevailing in the affected market.

When and where unemployment is high—it has been for some time in the construction industry—the offer of work can be used as a tool to drive down wage levels.

The legislative history of the act is replete with instances cited by congressmen and others testifying, in which local labor standards and practices were severely downgraded on Government construction projects.

Local labor and fair contractors in the areas where projects were being built were either not obtaining the work or were forced to work at lower wage rates than had been the custom. It was proven that contractors with itinerant work forces willing to work at substandard wages were obtaining an inordinate share of the available contracts through the unfair competitive practice of undercutting bids by using substantially lower wages than those prevailing in a locality.

And as a result, the economic stimulus of the Government's building programs did not accrue to the local communities where the projects were located.

Moreover, honest local contractors were denied the opportunity to compete on an equal basis with these unscrupulous contractors.

A need for Davis-Bacon protection of construction wage standards has remained since the law was enacted. And due to the unemployment during frequent job switches and searches when projects are finished, seasonal unemployment during cold and wet weather seasons, and cyclical unemployment, especially in residential construction, construction unemployment rates are consistently higher than most other segments of the economy.

In 1981, when the overall unemployment rate was 7.6 percent, construction unemployment was 15.6. Last year, the unemployment rate in construction averaged 20.1 percent, more than double that of the economy as a whole.

And I would be fair in saying that parts of our industry are seeing unemployment rates of 30, 40, and 50 percent. All of this proves the need for continued Davis-Bacon wage protection for the construction workers. Even though the Government-assisted housing projects have declined dramatically, those remaining are more enticing as employment opportunities.

It is essential that they not become the vehicle once again to depress prevailing wage rates in the absence of the Davis-Bacon provision in the federal housing legislation.

Now, Mr. Chairman, I'm going to save a little time for you. You have heard most of this stuff and we've been through it many times. I guess, really, what I'm saying here is mostly defensive, in the hope that there is no effort to remove from the legislation a Davis-Bacon provision.

So I would leave the rest of the testimony that I have prepared with regard to Davis-Bacon for the record and be happy to answer any questions that you may have.

But I want to point out just a few things and we won't have to listen to the whole testimony. And that is that insofar as onsite labor costs themselves are concerned, you see a chart here that was put up by the American Institute of Architects. I have in my paper a chart that was prepared by the National Association of Homebuilders. Both of them agree, neither are information that originated with me. And you'll see that the onsite labor costs in both charts represent about 15 percent of the total cost of the home.

Now that's a very small piece of the pie. The effect of Davis-Bacon on residential construction only affects about 10 percent of the total residential universe. And of that 10 percent and, again, I have to point this out because many people don't understand how Davis-Bacon is administered but of that very small piece of the residential community, only 35 percent of the 10 percent of those residential buildings where Davis-Bacon applies is there a rate that's established that is equal to the union rate.

So in 65 percent of all the wage determinations that are made in this country on residential buildings, the rates determined are less than the union rates. So it's not the imposition of the union rate. All it does, really, is establish what the prevailing rate for a certain work operation is in a given area and doesn't allow the builders to pay any less than that particular prevailing rate.

So what I have tried to point out in my testimony and in the comments that I have made is that Davis-Bacon does not add to the inflationary impact, does not increase the cost of residential construction, and therefore, should remain as a part of the law and should be included in any housing legislation that is passed.

[Complete statement of Mr. Georgine follows:]

TESTIMONY OF ROBERT A. GEORGINE, PRESIDENT, BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

Thank you very much for inviting me to appear before this committee to testify about Housing costs. My name is Robert A. Georgine. I am President of the Building and Construction Trades Department, AFL-CIO, which is composed of 15 affiliated national and international unions representing approximately four million building and construction trade workers who live and work in communities throughout the

United States. I have appeard before this committee on a number of previous occasions concerning specific legislative proposals.

While the committee currently has before it the Administration Bill S. 644, the Housing and Community Development Act of 1983, it is my understanding that your panel testimony is to be addressed to housing costs generally, and not with respect to any particular legislative proposals. The Housing construction industry today continues in great economic difficulties.

As you well know, the last several years have been of depression-era dimensions for this industry. Housing starts have been at a 40 year low. While some improvement has taken place in recent months, the road back will be long and painful. In terms of the workers I represent, the result of this depressed situation is a continuing high level of unemployment. Compounded for those still working is the large shortage of affordable housing, with very high mortgage interest rates.

My focus this morning is on the question of labor costs and particularly, the impact of prevailing wage protections, that is, the Davis-Bacon Act on certain federally assisted housing construction. We have been through this exercise before in this committee on the very same subject. There are half a million contractors in the American construction industry.

It's one of the last areas where an American worker can become an independent business owner through the skill of his hands and the drive of his ambitions. Through the years, many, many members of the unions affiliated with the Building and Construction Trades Department have become substantial businessmen. We are proud of them and of the spirit of free enterprise they typify. One reason for their ability to advance themselves has been the Davis-Bacon Act. It has operated as a shield against the abuses of predatory contractor sharks who, prior to enactment of Davis-Bacon, fleeced the Federal Government and the taxpayers, exploited their workforce, and brought misery to the communities that Federal efforts were supposed to help. Since it was signed into law by President Herbert Hoover in 1931, the Davis-Bacon Act has worked to require honest bids on Government contracts.

It has protected honest contractors from carpetbagging sharpies who would bid on the basis of less than prevailing wage rates in the area, and then use the control of project jobs to drive wages down. It has put a premium on good work and management in the American free enterprise tradition. The Davis-Bacon Act is intended to prevent Federal or federally-supported construction from being used as a vehicle to drive down wages prevailing in the affected market. When and where unemployment is high, as it has been for some time in the construction industry, the offer of work can be used as a tool to drive down wage levels. The legislative history of the Act is replete with instances cited by Congressmen and others testifying, in which local labor standards and practices were severely downgraded on Government construction projects.

Local labor and fair contractors in the areas where projects were being built were either not obtaining the work or were forced to work at lower wage rates than had been the custom.

It was proven that contractors with itinerant work forces willing to work at substandard wages were obtaining an inordinate share of available contracts through the unfair competitive practice of undercutting bids by using substantially lower wage rates than those prevailing in a locality. As a result, the economic stimulus of the Government's building programs did not accrue to the local communities where the projects were located.

Moreover, honest local contractors were denied the opportunity to compete on an equal basis with these unscrupulous contractors. A need for Davis-Bacon protection of construction wage standards has remained since the law was enacted. Due to unemployment during frequent job switches and searches when projects are finished seasonal unemployment during cold and wet weather seasons, and cyclical unemployment—especially in residential construction—construction unemployment rates are consistently higher than most other segments of the economy. In 1981, when the overall unemployment rate was 7.6 percent, construction unemployment was 15.6 percent.

Last year, the unemployment rate in construction averaged 20.1 percent, more than double that of the economy as a whole. And, I would be fair in saying that parts of our industry are seeing unemployment rates of thirty, forty, and fifty percent. All of this proves the need for continued Davis-Bacon wage protection for construction workers. Even though the government-assisted housing projects have declined dramatically, those remaining are more enticing as employment opportunities.

It is essential that they not become the vehicle once again to depress prevailing wage rates in the absence of a Davis-Bacon provision in federal housing legislation.

APPLICATION OF THE DAVIS-BACON ACT TO FEDERALLY FUNDED HOUSING CONSTRUCTION IS NOT INFLATIONARY

No careful economic analysis of the construction industry has identified any unique inflationary pressures resulting solely from application of the Davis-Bacon Act to the construction industry.

The convenience of criticizing the Davis-Bacon Act continues to distract attention from those underlying economic conditions which do, in fact, exert inflationary pressures on the industry. When prevailing wage determinations under the Davis-Bacon Act are correctly made, there should be no inflationary effect. Rates actually being paid in an area are simply identified and reflected in competitive bids on government work.

According to opponents of the Davis-Bacon Act and its applications to federally funded housing construction, prevailing wage determinations are not made correctly and, hence the inflationary impact of the Act. This belief stems from the present-day critics' favorite myth that the Davis-Bacon Act results in union wages being artifically imposed on just about all federally-financed construction. This is not true, particularly in the residential segment of the construction industry. Recent Labor Department data on Davis-Bacon prevailing wage determinations in 3,111 countries in the United States, its territories and possessions, indicates that in residential construction, only 13 percent of the counties had wage determinations equal to union rates; 25 percent of the counties had wage determinations that were mixed, i.e., union wages for some crafts and other than union wages for other crafts.

In 62 percent of the counties, therefore, all residential wage rates issued by the Department of Labor were other than union. As I have said on other occasions, the plain fact is that an overwhelming proportion of residential construction is performed by construction contractors who are not parties to collective bargaining agreements with local building trades unions. Hence, the vast majority of the wage determinations issued by the Department of Labor quite naturally reflect wage rates which are below those provided for in local collective bargaining agreements. Naturally, the Department of Labor's wage determinations applicable to federally assisted residential construction can be expected to reflect prevailing wage rates other than union rates.

Since the Department's figures indicate that this is the case, it would appear that the wage determination process is operating correctly, at least in the area of housing construction.

Nonetheless, opponents of application of the Davis-Bacon act to federally assisted housing construction promise great cost savings and lower taxes if the Act is eliminated from federal housing legislation. The fact is that Davis-Bacon has traditionally applied to less than ten (10%) percent of all residential construction throughout the country. This is because the Davis-Bacon provisions in the National Housing Act and other Federal Housing assistance legislation do not apply to federally insured loans for construction of dwellings in structures of less than eight dwelling units, a high percentage of all new units built in recent years.

Only about one-third of the new units built in larger rental projects have been Davis-Bacon. The drastic reduction in Federal budget authorizations for these programs in the last two years will drive the Davis-Bacon percentage even lower. Thus, it is clear that overall in this country, housing construction is largely unaffected by Davis-Bacon wage determinations.

These facts are particularly important when attempting to isolate any inflationary effect on housing costs produced by Davis-Bacon prevailing wage determinations. We are all familiar with the tremendous inflationary pressures generated by rising housing costs in recent years. Inasmuch as Davis-Bacon prevailing wage determinations are not really a factor in the one-family housing sector of the construction industry, the source of the constant price increases must be found in the rising cost of construction materials (these costs have doubled over the last decase), increasing land costs and interest rates.

As a mater of fact, the proportion of the total cost of housing attributable to on-site labor has dramatically decreased over the past three decades while the portion of housing costs attributable to these other factors increased significantly. On site labor costs which were 31 percent in 1949 are now between 15 and 16 percent. Building material cost declined from 38 percent to 30-32 percent while land has risen from 11 percent to 24 percent, financing from 5 percent to 11 percent, and overhead, profit and marketing from 15 percent to 23 percent.

HOUSING COST COMPONENTS—NEW SINGLE FAMILY HOMES

[Percentages]

	1949	1969	1982
Onsite labor	31	18	15-16
Building material	38	38	30-32
Land	11	23	24
Financing charges	5	8	10-11
Overhead and profit	15	13	13-16
Marketing			6-7
Total	100	100	90-106

Source: National Association of Homebuilders.

This trend will no doubt continue. Clearly it is not the labor share of the home selling price that has led to inflated housing prices. The builders, the materials producers, the land developers and the bankers are realizing unusual gains from the tremendous rise in selling prices, while construction workers have generally not even kept pace with inflation. Yet, there is no suggestion to cut back prices and profits of the other components costs of housing.

The actual fact is that any realistic reduction in labor costs which might occur would have a miniscule effect on a homebuyer's monthly mortgage payment. Amorization of the portion of the cost of a new home attributable to labor costs over the term of a mortgage accounts for five percent of the homeowner's monthly housing expenses. Therefore, any realistic reduction in labor costs would not materially affect the average homeowner's monthly payment. While little variation, the same relative importance would hold for the effects of different cost factors upon rents in new apartment houses.

INCLUSION OF THE DAVIS-BACON ACT IN FEDERAL HOUSING LEGISLATION IS STILL NECESSARY

The issue which opponents of the Davis-Bacon Act overlook is that the law does not simply reflect the remains of a product of the Great Depression. Rather, it reflects a particular philosophy of government which is that the price of labor should not become an element in the competition for Government construction contracts.

Regardless of its alleged impact on construction wages and costs, it is the principle which must be addressed whenever continued application of the Davis-Bacon Act to any Federally financed construction activity is considered. The harsh criticisms directed at the program tend to cloud the positive contribution that Davis-Bacon has been making in helping to protect the nation's economic and social progress. This is, after all, and industry which has the basic ingredient for cutthroat competition based on wage cutting.

Thus, except for differences that may exist between the contractors with respect to managerial capabilities, the structure of the industry is tailor-made for competition to impact adversely on wages and to generate pressures for wage cutting as a means to underbid competitors. As a result, fair minded contractors who resist these pressures will be forced out of business.

This type of situation obviously makes for instability—for industry as well as for the workers, and for the cities and towns thoughout the nation in which those workers and their families live—and is a constant threat to the achievement of economic social progress for both workers and contractors.

The prevailing wage protection provided by the Davis-Bacon Act remains necessary today in order to prevent lowering of labor standards in the local areas and give local honest contractors a fair opportunity to get Federal contracts. In sum, the allegation of inflationary tendencies in the wage determination process, while they have some superficial attractiveness to an inflation conscious public, is not a vaild criticism of the Act. The justification for the prevailing wage legislation is imbedded in the philosophy that underpins our free enterprise system.

The efforts to emasculate or even repeal the Davis-Bacon Act are, in reality, nothing less than efforts to deny construction workers the benefit of local prevailing labor standards and force honest contractors to choose between cutting worker's wages or lose out to unfair competitors who would not hesitate to use the Federal Government's construction activity, including federally financed residential construction, as the means to drive them out of business and monopolize the market. This should not be allowed to happen.

Senator TOWER. Thank you, gentlemen. Mr. Georgine, Davis-Bacon aside, is there anything that your union organization is doing or have you made any studies of how costs can be brought down in housing?

It occurs to me, of course, that the more houses that are built, the more work is available for your people. And I just wondered if you had done any studies. Do you have any work rules, for example, that might be under review because they might tend to be a little bit too inhibitive in terms of more efficient use of labor?

COLLECTIVE BARGAINING RELATIONSHIPS

Mr. GEORGINE. Our collective bargaining agreements, which include all of our work rules, are constantly under study, Senator. We have been making changes over the past 10 years. We have made very substantive changes in most of our collective bargaining agreements, trying to bring them into the 20th century and to keep up with technological change.

We are constantly working with home builder associations, where we have collective bargaining relationships, to try and advance whatever technological change will reduce the cost of housing. We have no restrictions on tools or no impediments that would prevent workers from accepting any new technological change that would decrease the cost of housing.

So we're doing that as a constant thing. We have no specific studies or recommendations that I could make to this committee other than those that are now in existence.

Senator TOWER. Do you have any particular comment on manufactured housing versus onsite construction? Do you have any particular union position on that?

Mr. GEORGINE. No. Well, we do have a union position; that is that we feel that manufactured housing has a place and that we do not oppose manufactured housing. There are many places where we have, in fact, represented the workers that manufacture the housing themselves.

So we think it is good and there is a place for manufactured housing, there is also a place for stick-built housing.

The need for housing is so great that there's room for everything.

Senator TOWER. Incidentally, on any of the responses that are given here, regardless of who the question is specifically addressed to, if any of the other panel members want to comment on the responses, they are perfectly free to do so.

Senator Riegle.

[No response.]

[Laughter.]

Senator TOWER. Let me ask Mr. Hogan what the attitude of the AIA is on manufactured housing?

Mr. HOGAN. I don't know if there's any specific AIA position on it. I'm serving on the Housing Committee of the AIA and we have an active liaison with the Manufactured Housing Association. I think we're very much in favor of manufactured housing. We think that there are ways that it can reduce costs and provide housing.

So we're in favor of that.

Senator TOWER. Do you have any additional comment on that, Mr. Dillon?

ISSUE OF STANDARDS FOR HOUSING

Mr. DILLON. Only to say that a year and a half ago, the institute testified before Congressman Gonzalez' committee on the issue of the standards. We tried to make the point that the Congress needs to make a definitive choice between several standards—in other words, two or more levels of acceptable performance—or a single standard for housing.

At the moment, the HUD manufacturing housing (mobile home) standard is just enough different from the regular MPS for one- and two-family dwellings, to cause difficulty. If there are to be differences between the performance levels provided by different standards, it should not be because of the way the housing is produced—that is, in a factory or onsite. NIBS would not say that there should be either a single standard or multiple standards; either can be justified. However, it is a choice that the country has to make so that we can get on with the job of producing needed housing for all economic levels, and not waste energies on the constant warfare that we have going on now over differences among standards that can result in competitive imbalances.

Mr. EHRLE. Mr. Chairman, could I comment?

Senator TOWER. Yes.

Mr. EHRLE. Will Ehrle, for the record, to comment on that standards issue also. One thing that we feel is very critical is that the performance equivalent, the engineering performance equivalency test be present. Technological innovations, innovations in construction techniques. Just one example. The compression airhammers today, of course, and air guns and nailers allow an individual worker to increase performance.

We would be hopeful that whatever the codes were—and I agree. We have had so many variations and the cost differences aren't that great. So that some amalgamation of codes to ar. engineering performance standard could be helpful.

Senator TOWER. You alluded to this in your testimony, but didn't address yourself directly to the question, Mr. Ehrle, that a lot of the perceptions that people have of manufactured housing stems from their impressions of the mobile home or trailer house, generally considered to be of somewhat more flimsy construction than the stick-built house.

You were suggesting that there has been substantial improvement made, qualitatively.

Is a manufactured home, on the average, as stable and sturdy and durable and safe as a stick-built house onsite?

SAFETY STANDARDS IN MANUFACTURED HOMES

Mr. EHRLE. Yes, sir, it is. And if I may, Mr. Chairman, for the record, I would like to submit some research and studies that have been done by the Department of Labor and Standards in Texas, the Texas Department of Labor and Standards, regarding code comparisons on health and safety items between the codes.

The answer is yes and frankly, it was because of the foresight of the Congress in 1974, in your Housing Act that was passed in December of that particular year, and implemented on June 15, 1976, by the Department of Housing and Urban Development, that set the code standards.

Mr. Chairman, I would be the first to admit that a trailer house or a mobile home of the old configuration, constructed prior to June 15, 1976, may or may not be safe, may or may not be durable. But my comment is that since June 15, 1976, with the comprehensive engineering performance requirements and the comprehensive inspection programs to insure code compliance, manufactured housing today is built exactly comparably from a health and safety standpoint as is site-built construction.

I'll implement that with an example. When we talk about fire incidences, there are some recent studies, which I also would like to submit for the record, since the question has been asked, that show fewer incidences of fire in HUD code-constructed manufactured homes. Now there's another statistic over here, though, that NFBA points to from time to time that says, while that may be true on fewer incidences, when you do have an incident, your death rate is higher.

Frankly, that is also correct. But the reason is that the home is much smaller. For example, you don't have smoke inhalation problems when you have an old home with 12-foot ceilings for a substantial amount of time because the smoke rises.

In a manufactured home, with a 7½-foot ceiling, more compacted space, the home is smaller, you obviously have situations where it's imperative to have egressed windows and things of that nature. The code provides for that.

But, yes, sir, I'm sorry for the lengthy answer, but the statement is today, a manufactured home, placed on a permanent foundation system, in accordance with the one- and two-family dwelling code, is equally as safe and equally as durable and, perhaps, in some instances, more so, than a home built onsite.

Senator TOWER. Do any other members of the panel have any comment on that statement?

[No response.]

Senator TOWER. Gentlemen, we appreciate your giving your time to us and making this contribution to the record. Again, I apologize for having to delay you to the afternoon session. But you've been very helpful.

We thank you for appearing before the committee. The hearing is adjourned.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

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BUILDING SCIENCES

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March 25, 1983

The Honorable John Tower
United States Senate
Washington, D.C. 20510

Dear Senator Tower:

Thank you for inviting the Institute to participate in the March 8 panel on the cost of housing and to address the future of the FHA Minimum Property Standards.

In my response to your oral query regarding the HUD mobile home/manufactured housing standards (Federal Manufactured Housing Construction and Safety Standards), I mentioned testimony I had given before the House Subcommittee on Housing and Community Development on September 10, 1981. A copy of the written testimony given at that time is enclosed for your information.

On the same subject, the Institute recommended a course of action regarding this standard in its August 15, 1981, report Federal Regulations Impacting Housing, Building and Land Development: Recommendations for Change, Phase II. A copy of that recommendation also is enclosed for your information.

Finally, in your March 4 letter to Steven L. Biegel, AIA, our Director of Program Planning, asking that the Institute supply a witness for your March 8 panel on the cost of housing, you also asked for our insight into the process of assimilating new technology into the home building process. This is, of course, an extremely important issue and also one which the Institute was charged with addressing in its original authorizing legislation (P.L. 93-383). I did not address it in my testimony because doing so might have detracted from the more immediate issue of HUD actions regarding the phasing out of the MPS. However, this does not mean that the Institute views the issue of technology flow in the building community to be of lesser import. Indeed, the Institute considers the technology flow process to be one of its primary areas of concern. Therefore, in the hope that it might be possible to include it in the hearing record, I am enclosing a response to the question dealing with this subject as you posed it in your March 4 letter.

Again, thank you for the opportunity to appear before the Committee.

Sincerely,

Robert M. Dillon, AIA
Vice President

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TOWER

HOME BUILDING TECHNOLOGY

QUESTION:

What are the views of the National Institute of Building Sciences regarding the process of assimilating new technology into the home building industry?

ANSWER:

The process of new technology assimilation in the U.S. home building industry has not matured at a rate commensurate with the need--that is, the need to achieve productivity gains and thus increased cost effectiveness through technological improvement. To further complicate matters, an increasing array of barriers to technological innovation have been erected over the past twenty years. In my response to the question concerning the future of the FHA Minimum Property Standards, I called attention to one of these barriers--the growth in regulatory activity and the debilitating effects that flow from increased regulation and the acccompanying regulatory overlap, duplication, and conflict. Another serious barrier to innovation, is the increasingly litigious environment within which all participants to the building process must operate. It is hard to imagine a climate less conducive to innovation than one in which the potential downstream losses due to litigation can far outweigh any possible gains, and can in fact be ruinous to both businesses and reputations. This is not to say that all regulation is bad, nor that all litigation is unjustified; simply that raising the odds on "risk taking" is not necessarily the only nor the best way to achieve the dual goals of progress and consumer protection.

When the Congress authorized NIBS in 1974, it recognized many of these problems and charged NIBS with seeking their solution. Briefly stated, this meant finding ways to rationalize the regulatory environment at all levels of government, ways to facilitate the process of information flow, and ways to accelerate the introduction of technology.

It is this latter need that is at issue here--i.e., the need to accelerate the flow of innovative building materials, products, components, subsystems, and systems into housing and building. To do this, two important new things must be done: (1) performance criteria must be created; and (2) an authoritative, nationwide and nationally recognized process for evaluating and approving or prequalifying such innovative technology must be put in place.

Performance criteria, when available, will provide the innovator with authoritative guidance on what performance is needed to reach a given market, or, alternatively what market his innovation will satisfy if it was not specifically targeted in advance. These criteria must, in as unconstraining a manner as possible, address the functions to be served and the environment within which that service must be rendered--i.e., what performance is needed and/or desired and how its attainment will be assured in advance of actual application.

Prequalification implies that the innovator knows the market he wishes to reach, and, therefore, the range of performance requirements he must seek to satisfy. The material, product, component, subsystem, or system can then be evaluated against these requirements and a determination made that the innovation will or will not measure up, or, in those instances where there is no actual pass/fail point in a requirement, the degree to which the requirement will be satisfied in use.

Where the innovator has no specific end use market in mind for his product--as is often the case with generic materials for example--the current practice of certifying compliance with one or more standards can be used, or, alternatively, the performance characteristics of the innovation can simply be determined and made known so that users can match those characteristics against their needs. In the latter case, the prequalification takes place at the time the user has satisfied his own and/or regulatory needs.

For a variety of reasons, the performance of whole buildings, including housing, is quite difficult to predict. There are very few buildings that are not rooted in the land and thus dependent for their performance on the performance of their foundations, the site, and the utility systems to which they are connected. There are few opportunities for reproduction, let alone high volume reproduction, of many building types. Most buildings, including multifamily housing, are so large that full-scale testing beforehand is not feasible. In short, the prequalification and component approval processes must be able to deal with a myriad of parts, destined for a variety of end uses, and under a variety of conditions, some of which cannot be foreseen by the innovator.

NIBS has been pressing forward in an effort to deal with these needs, and to create or bring about a nationwide, authoritative and nationally recognized mechanism for housing and building technology evaluation, prequalification and approval. The potential for gains in terms of procedural efficiency, cost reduction, and quality improvements, if such a process or set of processes can be brought into being, is both significant and self-evident.

The present day approval processes for building materials, products, components, subsystems, and systems in the United States are numerous, and, such as they are, have evolved in response to a variety of needs--e.g.: Federal, State, and local governments as they seek to assure compliance with building codes and other regulatory requirements; Federal, State and local governmental agencies as they seek to assure compliance with their assistance, underwriting, or procurement requirements; and, housing and building owner-users or their agents as they seek to assure compliance with both regulations and their own requirements.

As already noted, certification of compliance with established requirements, whether regulatory or otherwise, is one way of gaining access to the marketplace and achieving acceptable performance. Standards are one expression of agreed upon requirements. They are the linchpin of the current building procurement and regulatory processes. They are an agreed upon and prescribed set of rules, conditions, or requirements concerned with defining something, measuring something, doing something, or testing something. Standards emanate from a variety of sources: consensus standards bodies, trade associations, professional and technical societies, and even proprietary standards and testing organizations. When standards are the result of a voluntary consensus process, they generally are produced by a representative number of the country's best informed individuals on the subject of the standard. Standards are an expression of the scientific and technical foundation on which the nation rests. Certification of compliance with a standard or standards, and validation of that certification when necessary, is, therefore, an important part of today's acceptance processes for building products and materials.

Recognition of the need for a nationally recognized system for technology evaluation, prequalification and approval, and its importance in the marketplace, has increased dramatically in the last decade. This is due, at least in part, to the already noted increase in the frequency of product liability claims and regulatory activity. In fact, the product acceptance programs that have been instituted by model code organizations, trade associations, political jurisdictions, building owner/users, and others, are themselves an acknowledgement of this need. Most have evolved independently and provide services that are to varying degrees, similar. However, they all fall short of the kind of system that will engender the respect that can overcome resistance to change, reluctance to accept risk, and the inability of most decisionmakers to cope with new and innovative technologies and the costs involved.

Today there are innovative products and materials that enter the home building industry without the benefit of an authoritative evaluation, prequalification and approval--in fact, without having been subjected to any process for determining adequacy for the intended use. Significant occurrences of this nature need to be identified, and their origins and the channels they followed to the marketplace need to be traced. The transfer of technical information between industries also is slow and haphazard. There are no incentives to isolate technologies in, for example, the aerospace or automotive industries, and determine their potential usages in housing and building. This fact gives rise to the corollary need for better communication among industries, and for a positive system for bringing the potential benefits of high technologies to the housing and building community.

Allegations that certain innovative products and materials are restricted from the domestic market, confusion as to the capabilities or acceptance of some certification and validation programs, and concern regarding costs of currently available certification/validation services, are among the more important issues that need to be addressed. It is this current status of change and controversy that invite and require careful study of ways to improve the process of technology introduction in the housing industry. This NIBS is doing.

The overall goals of the NIBS effort are: (1) to document and assess how current product approval practices, including certification and validation programs, are affecting the acceptance, introduction, and use of valuable and needed building materials, products, components, subsystems, and systems; (2) to determine if unnecessary impediments exist, and, where such impediments do exist, to recommend specific and practical ways to remove them; and (3) to develop an efficient, well coordinated, voluntary, nationally recognized system for performance criteria development, and for technology evaluation, prequalification and approval.

Subject to continued improvement and refinement by a body of informed and involved individuals drawn from a wide spectrum of public and private interests in housing and building, including consumers, the current NIBS project consists of the following phases:

PHASE I Documentation of Present Practice and Programmatic Requirements

A. Description of the socioeconomic, administrative, legal, and technical needs, problems and opportunities associated with the acceptance of building materials, products, components, subsystems, and systems in the United States.

B. Identification of current product acceptance practices used by the public and private sectors of the building community, and development of basic programmatic requirements for an authoritative, nationwide, and nationally recognized system for the evaluation, prequalification, and approval of materials, products, components, subsystems, and systems based on a survey of:

- State and local building regulatory agencies and model code-writing organizations.
- Developers, and builders and contractors.
- Design professionals.
- Mortgage lenders, insurers, testing laboratories, and labor and trade organizations.
- Building owner/users, including consumers.
- Federal construction and construction-related agencies.

Phase II Analysis

A. Development of criteria with which to compare current product approval practices, including certification/validation programs, with fundamental user needs and, if overlaps, gaps and inadequacies exist in current practices, identify them.

B. Preparation of a comparative analysis of the needs of each user category in relation to available means.

Phase III System Development and Testing

A. Development of techniques, including benefit-cost and risk assessment techniques, for evaluating recommendations for improvement of existing approval/acceptance practices, and for evaluating alternative systems of building product evaluation, prequalification, and approval.

B. Development of alternative conceptual programs for a nationally recognized system of building product evaluation and approval that address the broad range of requirements identified in the documentation and analysis phases.

C. Evaluation and ranking of the alternatives based on the assessment criteria.

D. Identification of individual recommendations for change, addition, and other improvements to current building product evaluation and approval practices.

Phase IV Implementation

A. Development of a series of recommendations and a schedule for action by the appropriate building community organizations to implement the proposed program.

B. Development of monitoring, evaluation and reporting programs.

This effort will be coordinated with the corollary Institute program to, long-range, evolve a system for the development and promulgation of performance criteria that ultimately must provide the basis for any meaningful prequalification system.

NIBS believes that only through the type of system discussed herein can the flow of much needed new technology in the housing and building industry be accelerated.

Finally, because the need to encourage housing technology at its cutting edge is so important to future housing affordability, the Institute is exploring the possible need to intervene directly in the prequalification process for the truly innovative materials, products, and services. Most public agencies and private organizations--except, for example, the limited reach of the current FHA materials-release program--simply are not equipped to deal with, nor do they necessarily see their mission as dealing with, the truly innovative aspects of technology. By truly innovative technology, it is meant entirely new materials, products, and services, where there is no record of in-use performance, nor even a record of performance of like materials, products, or services from which to extrapolate means for predicting performance. A capability of this nature is desperately needed.

The current NIBS program already enjoys a measure of support by Federal agencies and the private sector. However, much greater support and participation is needed if the scope of the program is to be commensurate with the need. Any help the Committee can give NIBS in making this program and the overall goals a reality will be greatly appreciated.

Statement of

NELSON M. ROSENBAUM

Chair, Task Force on Finance and Governance

National Neighborhood Coalition

on

S. 586, Neighborhood Development Demonstration Act of 1983

My name is Nelson M. Rosenbaum. I am President of the Center for Responsive Governance, a non-profit research institution in Washington, D.C., and Editor of the Journal of Community Action. I also serve as Chairperson of the Task Force on Finance and Governance of the National Neighborhood Coalition, on behalf of which I am pleased to submit this testimony in support of S. 586, the Neighborhood Development Demonstration Act of 1983.

The Neighborhood Coalition is composed of over forty national non-profit organizations which either enroll neighborhood groups as members or serve community organizations through research, training, or technical assistance. Through its monthly meetings and its informational activities, the Coalition seeks to advance the interests of some 10,000 neighborhood-based organizations engaged in development and service activities within their communities.

The National Neighborhood Coalition strongly endorses S. 586 and urges its adoption by Congress. This endorsement and support is based upon four points:

1. The proposed legislation would help to maintain the vital infrastructure of neighborhood organizations that has developed over the last twenty years.

Neighborhood-based non-profit groups engaged in community service and development represent a vital infrastructure of organizational capability in low and moderate income communities across the United States. This infrastructure reflects the aspirations of citizens in these communities for a better future. Over the past two decades, neighborhood organizations have demonstrated their ability to rehabilitate housing, train people for jobs, spur new enterprise development, deliver essential services, and sponsor neighborhood physical improvements. Now, given recent drastic cutbacks in the availability of federal funds, this vital infrastructure is at risk.

To a large extent, the growth of neighborhood-based organizations over the past two decades has been spurred by the availability of federal funds. Neighborhood groups realize that the dependence on federal funding could not and should not last indefinitely. Most recognize that a transition to other sources of funding is necessary and feasible over a reasonable period of time.

Many organizations have already established partnerships with the corporate sector. Others are actively selling their services to the public. Still others are actively engaged in grassroots fundraising. But they cannot make this transition without any assistance. We strongly believe that it is the responsibility of the federal government to help neighborhood groups make this transition effectively by providing continued government funding in a form that will encourage the development of new funding strategies. That is one of the key objectives of the matching grant provision of the Neighborhood Development Demonstration Act of 1983 and we support that provision vigorously.

2. The proposed legislation supplements and reinforces other recent initiatives to strengthen private giving to non-profit neighborhood organizations.

The Economic Recovery Tax Act of 1981 explicitly recognized the importance of encouraging charitable giving by low and moderate income citizens by allowing non-itemizers to deduct a portion of their donations beyond the standard deduction. The explicit rationale of the change was the hope that small neighborhood-based, self-help organizations would thereby be enabled to raise additional revenue from their constituencies. The 1981 Tax Act also raised the proportion of taxable income that corporations could donate to non-profit organizations from 5% to 10%. At the state level, some eight states now have enacted "Neighborhood Assistance Plans", through which corporations may take a state tax credit for a portion of their donations to neighborhood development organizations. Pennsylvania is the leading state in the nation in the development and implementation of its Neighborhood Assistance Plan. The proposed bill would go a long way toward encouraging and reinforcing these other initiatives by providing a strong additional incentive for private giving.

3. The proposed legislation minimizes bureaucratic discretion, delay and red tape.

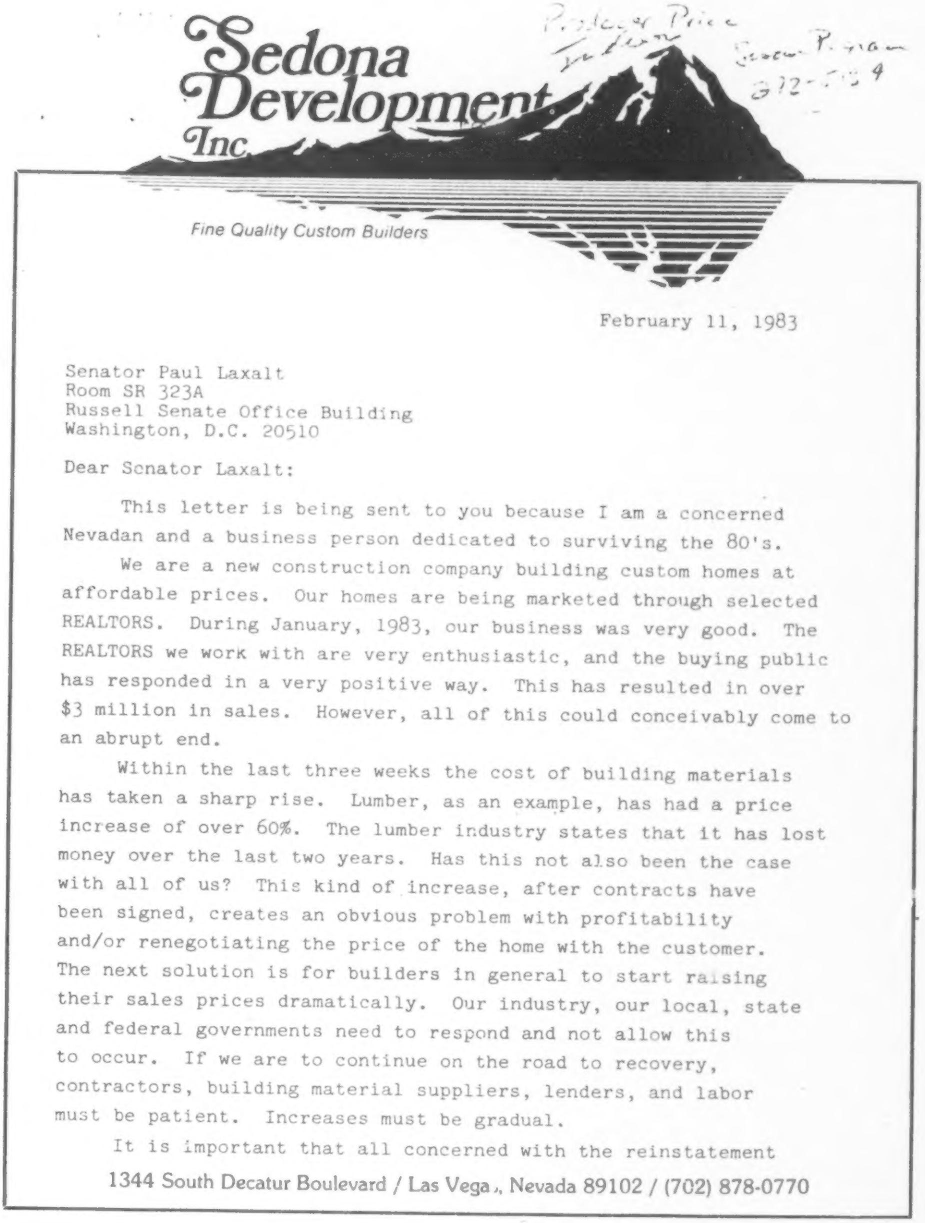
We applaud the fact that S. 586 establishes a very simple mechanism of federal funding. Eligibility for the program is established through clear legislative criteria. The selection process is simple and straightforward, guided by a peer review process rather than by the exercise of arbitrary authority by bureaucrats in Washington. Participating organizations receive their funds through a simple certification procedure which is subject to audit. Organizations are free to use the funds for any of the eligible purposes based on their track record--without excessive guidelines from Washington or pressure to conform to a favored model. Thus, in contrast to previous grant programs which provided funds to neighborhood groups, the proposed bill establishes a much improved mechanism for federal financial assistance.

4. The proposed legislation would provide unrestricted funds that could be used to leverage private sector partnership in neighborhood development.

Previous federal grants programs supported specific projects by neighborhood development organizations. While leveraging of private sector investment was sometimes required if feasible, the restricted nature of the funds narrowed the scope of potential partnership. Under the new mechanism of funding outlined by the proposed legislation, the funds provided would be general and unrestricted, usable for the purposes which the organization feels are most appropriate. Thus, these funds would be available to leverage a wide range of private sector investments which are available to neighborhood groups. The Local Initiative Support Corporation, for example, has a capital base of some $30 million available for investment in neighborhood development on a leveraged basis.

Within the context of our strong support of S. 586, the National Neighborhood Coalition also wishes to suggest one change in the proposed legislation for consideration by the Subcommittee. The Coalition endorses the need for the closest possible coordination of activities between neighborhood-based organizations and agencies of local government. Their activities must be mutually supportive. The Coalition feels, however, that the provision in S. 586 for mandatory local government certification of applications for assistance prior to submission may be conducive to delay and may impede rather than encourage the coordination which all parties desire. The Coalition suggests, as an alternative, a time-limited opportunity for local government to review applications and to specify areas of inconsistency. Should the local government find inconsistencies, these should be brought to the attention of the Secretary of HUD, who could then evaluate means of resolving the difficulties. This would serve the purpose of insuring consistency, while still keeping applications flowing on a timely basis. At the Subcommittee's request, the Neighborhood Coalition would be happy to suggest specific legislative language reflecting the recommended approach.

Once again, let me express my appreciation to the Housing and Urban Affairs Subcommittee for this opportunity to submit testimony. The Neighborhood Coalition commends Senator Heinz and the co-sponsors of the legislation for their efforts in behalf of stronger neighborhoods.



Sedona Development Inc.

Fine Quality Custom Builders

Producer Price Index

Steven P. [illegible]
372-[illegible]4

February 11, 1983

Senator Paul Laxalt
Room SR 323A
Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Laxalt:

This letter is being sent to you because I am a concerned Nevadan and a business person dedicated to surviving the 80's.

We are a new construction company building custom homes at affordable prices. Our homes are being marketed through selected REALTORS. During January, 1983, our business was very good. The REALTORS we work with are very enthusiastic, and the buying public has responded in a very positive way. This has resulted in over $3 million in sales. However, all of this could conceivably come to an abrupt end.

Within the last three weeks the cost of building materials has taken a sharp rise. Lumber, as an example, has had a price increase of over 60%. The lumber industry states that it has lost money over the last two years. Has this not also been the case with all of us? This kind of increase, after contracts have been signed, creates an obvious problem with profitability and/or renegotiating the price of the home with the customer. The next solution is for builders in general to start raising their sales prices dramatically. Our industry, our local, state and federal governments need to respond and not allow this to occur. If we are to continue on the road to recovery, contractors, building material suppliers, lenders, and labor must be patient. Increases must be gradual.

It is important that all concerned with the reinstatement

1344 South Decatur Boulevard / Las Vegas, Nevada 89102 / (702) 878-0770

Sedona Development Inc.
Fine Quality Custom Builders

of a strong economy take a firm stand against such unacceptable price increases. How this can be accomplished, I'm not certain. We cannot just stop buying lumber and other materials. What do you suggest?

I would be willing to serve on a committee, sanctioned by a local or federal government agency, whose task it would be to investigate and attempt to solve this problem. I feel these same state and federal entities should let it be known that they are against such dramatic increases in pricing. The inability to raise prices over the last two years cannot be the basis for increases within such a short time frame.

I look forward to your response. Please feel free to call on me if I can be of any assistance to you regarding this serious matter.

Sincerely,

Rodney C. Yanke
Chairman of the Board

RY/ps

1344 South Decatur Boulevard / Las Vegas, Nevada 89102 / (702) 878-0770

Ætna

Corporate Public Involvement
151 Farmington Avenue
Hartford, CT 06156
(203) 273-0123

March 10, 1983

Chairman, Senate Housing Subcommittee

Dear Mr. Chairman:

On behalf of Ætna Life & Casualty, we would like to offer our support to the Neighborhood Development Demonstration Act of 1983. The Act would provide community based development organizations with the unrestricted seed capital they so critically need to leverage private contributions and investments for housing and economic development projects in their neighborhoods.

We have had the privilege, during the past three years, of participating in a unique public-private-community partnership that we believe demonstrates what can be accomplished by neighborhood development organizations. Our National Urban Neighborhood Investment Program, undertaken jointly by Ætna Life & Casualty and the National Training and Information Center, has operated in first six, and now 11, low income urban neighborhoods to combine grant and investment funds with training and technical assistance. The program has two principal aims: to build the capacity of community based advocacy groups to lead the revitalization of their neighborhoods, and to leverage the participation of local governments and other private donors and investors.

A case study of the results of the first two years of our program is enclosed for your use. We would like to highlight a few of the key points we have learned from our experience:

1. Neighborhood organizations, even those with little prior experience, can be successful in their efforts to operate as developers in neighborhoods where little private or public investment is occurring.

2. Ætna's up-front commitment to finance mortgages at below-market rates for feasible development projects sponsored by the neighborhood groups enabled them to leverage financing from city programs and other private lenders that would not otherwise have been available.

3. Similarly, the neighborhood organizations were able to use our grant dollars to leverage other public and private contributions to pay for their development staff and operating costs. With the loss of funding previously available through programs like VISTA and the Community Services Administration, this is the most difficult kind of funding to obtain, but without it neighborhood groups cannot sustain the staff necessary to plan and package development projects for financing.

4. Once neighborhood organizations gain some experience in development, they are able to sustain their momentum, undertake projects of increasing scale and complexity, create jobs in their communities, generate revenues to support their own operations and, most important, make a significant difference in the quality of life in their neighborhoods.

Ætna Life & Casualty undertook this program because we believe that the economic health of inner city neighborhoods is important to the long term success of our businesses. During the first two years of our program, about 900 units of housing for low and moderate income people have been developed; Ætna's $11 million in mortgage commitments has leveraged over $1 million in grants and $33 million in investments for the original six neighborhood organizations. The success of the program demonstrates to us, and we hope to many other corporations, that a corporate investor can do business successfully with community based development organizations in a manner that meets corporate objectives as well as community objectives, and serves the public interest. Our satisfaction with the results of the first two years of our work in New York, Chicago, Philadelphia and Cleveland led us to expand the program in 1982 to neighborhoods in Washington, D.C., New Orleans, LA, Lowell, MA and our headquarters city, Hartford, CT.

We believe that the Neighborhood Development Demonstration Act of 1983 would contribute to the revitalization of low income neighborhoods in three ways. First, it would provide badly needed and hard to obtain "venture capital" to the neighborhood groups best able to set development priorities and carry out successful projects in their communities. Second, the knowledge that private contributions will trigger federal matching funds will stimulate corporations, foundations and individuals to enter into partnerships with community based organizations in the cities that are important to them. Third, it will help many organizations achieve the critical mass in their development, job-creating and revenue generating ventures that can sustain them beyond the three-year period of the demonstration program.

For these reasons, Ætna Life & Casualty urges you to favorably report the Neighborhood Development Demonstration Act of 1983. As you can see from the foregoing, we have some experience in working with neighborhood development organizations and would be pleased to assist you in any way we can.

Sincerely,

Sanford Cloud, Jr.
Chairman, Corporate Responsibility
Investment Committee

Alison G. Coolbrith, CLU
Vice President
Corporate Public Involvement

FISCAL YEAR 1984 HUD AUTHORIZATIONS

WEDNESDAY, MARCH 9, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 10:10 a.m., in room SD-538, Dirksen Senate Office Building, Senator John G. Tower presiding.

Present: Senators Tower, D'Amato, Trible, Riegle, Sarbanes, and Lautenberg.

OPENING STATEMENT OF SENATOR TOWER

Senator TOWER. The committee will come to order.

This morning we turn to two specific subjects in the HUD authorization bill. First, we will consider the reauthorization of the community development block grant and urban development action grant programs.

These are two programs in which I take some pride of sponsorship and believe they have more than met the expectations that Congress set in their original enactment.

There is no question these programs ought to be reauthorized for another 3 years, but overlying simple reauthorization is a more complex new federalism proposal to merge community development block grants with general revenue sharing and to merge the state-run small cities block grants with some 20 other State grant programs.

This proposal contains the potential for fundamental changes in the objectives and structure of the existing program. If the new federalism package is adopted and the States and cities continue to use Federal funds to meet the physical development needs of local government, though their expenditures principally serve the needs of low and moderate income citizens.

In this and other hearings, the Banking Committee intends to check the impact.

This morning's second panel will explore the major new proposals in the fiscal year 1984 HUD bill. HUD intends to change the basis on which it distributes operating subsidies to public housing agencies from the performance funding system to a system based on fair market rents.

Our panel will explore all sides of the issue. The committee must decide whether or not fair market rents affect the rents charged by private landlords in different market areas, bear actively on the operating costs, and whether such a system can be transferred to public housing agencies to reflect their cost of operation.

This is such an important issue that I propose to loosen our normal rules somewhat. We will have our normal question period, but I hope we will encourage the free exchange of ideas among and between our four witnesses and the committee members.

Before I turn to our panel this morning, let me yield to the distinguished ranking member of the subcommittee, Mr. Riegle.

Senator RIEGLE. Thank you, Chairman Tower.

I am delighted to see our witnesses, and I am anxious to hear from them.

I would like to say one other thing that you should be aware of; that is, the Senate Budget Committee, of which both Senator Tower and I are members, are also meeting this hour in the initial phases of markup of the budget. So we are caught in the dilemma of having to be two places at once.

So from time to time I am going to have to leave to be present upstairs. Don't take that as a sign of a lack of great interest in your presentations, because we are very interested in what you have to say this morning.

Thank you, Mr. Chairman.

Senator TOWER. Budget deliberations, of course, are of enormous importance. I, for one, of course understand the necessity for Senator Riegle to be there.

I suggest, however, that I will stay here and will trust my distinguished friend from Michigan to fiercely defend my interests in the Budget Committee. [Laughter.]

Our panel on community development this morning consists of the Honorable Vincent J. Thomas, representing the U.S. Conference of Mayors, from Norfolk, Va., the mayor of that very fine city, which I personally became acquainted with as an 18-year-old lad in the U.S. Navy, further back than I care to remember. I imagine Mayor Thomas was a mere boy at the time.

The Honorable Jim Scott, representing the National Association of Counties, county supervisor, from Fairfax, Va.

The Honorable Kathy Reynolds, representing the National League of Cities, a city council member from the mile-high city of Denver.

And Mr. Juan Montes, representing the Working Group for Community Development Reform, Campana Pro Preservacion del Barrio, from El Paso, Tex. He is accompanied by Mr. Paul Bloyd, also of the Working Group.

First off this morning, we will hear from the witnesses in the order that they are listed on our agenda. We will hear first from the Honorable Vincent J. Thomas, mayor of Norfolk. Your Honor, you may proceed.

May I say at the outset that if you have lengthy statements prepared we would prefer that you submit those for the record—they will printed in full, in their entirety in the record—and proceed to summarize them so we can give over as much time as possible to questions.

STATEMENTS OF VINCENT J. THOMAS, U.S. CONFERENCE OF MAYORS, MAYOR, NORFOLK, VA.; JIM SCOTT, NATIONAL ASSOCIATION OF COUNTIES, COUNTY SUPERVISOR, FAIRFAX, VA.; KATHY REYNOLDS, NATIONAL LEAGUE OF CITIES, CITY COUNCIL MEMBER, DENVER, COLO.; AND JUAN MONTES, WORKING GROUP FOR COMMUNITY DEVELOPMENT REFORM, CAMPANA PRO PRESERVACION DEL BARRIO, EL PASO, TEX., ACCOMPANIED BY PAUL BLOYD

Mr. THOMAS. Thank you, Mr. Chairman and Senator Riegle.

I am Vincent J. Thomas, indeed the mayor of Norfolk, Va., the capital of the U.S. Navy, and we appreciate your continuing interest in the activities in our community, Senator.

I am also representing the U.S. Conference of Mayors, where I chair the Standing Committee on Community Development, Housing and Economic Development.

TWO HIGHEST PRIORITIES

Reauthorization of the community development block grant and urban development action grant programs are two of the highest priorities of the U.S. Conference of Mayors this year.

These programs have proven to be efficient, popular and effective vehicles for providing assistance to cities that need those programs.

We appreciate very much the strong support that this committee and its members have extended in the past to community development and UDAG, and we look forward to working with you, reauthorizing it for another 3 years.

In preparation for this reauthorization process, I chaired a meeting in January of the U.S. Conference of Mayors, and I want to share some of the views of that group and their concerns here today.

Our concerns about reauthorization are, first, the funding level, and we as the Conference of Mayors support a funding level of at least $4½ billion in fiscal year 1984.

We ask for that increase because of the erosion of the program through inflation since it has been funded at a constant level, and also because there are 60 additional cities which are covered in the entitlement area this year. That represents about 10 percent of the whole program.

SUPPORT ASSISTANCE FOR NEW CONSTRUCTION FOR HOUSING

We support assistance for new construction for housing. However, the Conference of Mayors strongly opposes the administration's proposal to add new construction of housing to the list of eligible activities for the community development block grants. We feel this should be a separate program with a separate purpose, separately funded.

We oppose the administration's request for repeal of the lump sum drawdown provisions of the current law.

We oppose the repeal of section 312 and feel it should be funded at least to the extent of the returns to that program.

We also oppose repeal of section 108 loan guarantee programs, which have become increasingly popular with the cities.

As far as the public services cap goes, we support that cap, but also support a process whereby there can be waivers granted to particular cities.

In my city, for instance, 17 percent of our CD program is in public services. This covers the operation of a number of community centers and recreation centers which are carryovers from the old model cities programs. At this time of high unemployment, about 90 percent of their complement are low-income minority persons who work to run these centers. Any reduction, any failure to be able to get a waiver on this program would probably cause the layoff of these people.

In the UDAG program, we have two major concerns growing out of the administrative proposals. First, we reject the administration's proposal to reduce the authorization to $196 million in fiscal year 1984.

The economy appears to be beginning its long-hoped-for recovery. This program is one that will operate best when conditions are improving and interest rates are going down. Although these financial conditions have kept some of these UDAG projects from being funded, now that things are picking up, we feel that there are a number of—a great backlog of projects waiting to be funded.

So cutting this program at this particular time seems to be very unwise. We feel that those carryover funds will be very quickly used up as our economy improves.

Second, the administration has proposed to shift central cities of MSA's with less than 50,000 population into the small cities category for UDAG purposes. The stated reason is that the current small cities universe is not able to use the funds set aside for it.

Well, is it lack of investment interest? Is it lack of capacity?

Surely, it is not for lack of additional cities in the competition. Again, this is designed for a healthy economy.

URGE THE COMMITTEE TO REJECT HUD'S PROPOSAL

We urge the committee to reject HUD's proposal.

Under the housing assistance programs, the Conference of Mayors strongly supports the passage of new legislation authorizing housing assistance programs for the coming decade.

We believe that this must be a balanced program, and the balance should include funding for section 202 housing for the elderly and handicapped, public housing development, separate rural housing programs, substantial new section 8 existing housing certificates.

In addition, the time has come to adopt a new program to assist in the development of new and rehabilitated multihousing programs. The mayors feel very strongly on this point.

Last year, your committee made a serious effort for the new production program. The result, S. 2607, was a major improvement over the administration's proposal. We did not agree with every detail of this bipartisan effort; however, we strongly support the central role the bill gave to local and State governments. We support the flexibility to undertake new construction as well as rehabilitation.

On the other hand, we feel the bill was burdened with unnecessary restrictions and the funding provided was inadequate to the need.

As you know, the Conference of Mayors has supported a block grant approach to providing capital assistance for housing production for some time. In the last 2 years we have worked closely with the National League of Cities and with the Council of State Housing Agencies to create a broad consensus on the details of such an effort.

The central tenets of our approach can be summarized as follows:

First, continued operation of the section 8 existing certificate program to provide long-term subsidies.

Second, sufficient funds to make the program workable in a broad range of localities, at least $1 billion in contract authority.

Certainty of funding levels for the primary recipients, especially cities. Localities must know how much they can reasonably expect to get in the program in order to justify the tremendous staff investment that participation would entail.

Fourth, to allocate the funds based on actual housing needs.

Fifth, maintain a diversity of production mechanisms. There should continue to be a role for HUD and for State housing finance agencies and States as well as the cities.

Sixth, permit maximum flexibility in the use of funds. Please don't try to tell us how to make housing production take place.

Seventh, a substantial portion of the funds must be set aside for production or rehabilitation of units for low- and moderate-income persons.

We will work with you to implement the details of that program.

PUBLIC HOUSING HAS TWO MAJOR CONCERNS

In public housing we have two major concerns; first, the change in the formula used to provide operating subsidies. Based on what we know of this, we are concerned that this new system will end up leaving major housing authorities with insufficient funds to operate their housing inventory. We urge Congress to examine these proposals closely. Budget concerns should not be an overriding issue in determining the assistance level of the existing assisted housing.

It would seem to me, Mr. Chairman, that our first priority in the whole matter of housing is to protect and preserve what we now have. It is too expensive to replace anything. So we have got to look to the necessary funding of our public housing stock and to encourage the conservation of our private housing stock.

This committee should direct HUD not to change the current system until the Congress has given explicit approval to any new approach.

Second, the administration proposes to replace the current modernization program with a yearly replacement reserve added to the operating subsidy payment. We are quite concerned about this approach.

At a time when we know what is happening to the infrastructure of cities, and because of neglect, it does not seem wise to me to lump modernization funds with operating funds, because we are short always of operating funds, and we know that those modernization funds will ultimately be absorbed in the operating budget.

So we strongly urge that the modernization funds be kept.

Mr. Chairman, I have submitted a more detailed written statement for the record, and I have some other exhibits that I would like to hand to the committee that can help with these matters before it.

[The complete statement follows:]

STATEMENT OF

THE HONORABLE VINCENT J. THOMAS
MAYOR, CITY OF NORFOLK

Mr. Chairman, members of the Committee, my name is Vincent J. Thomas. I appreciate the opportunity to testify before you today as Mayor of Norfolk, Virginia, and as the representative of the U.S. Conference of Mayors, where I chair the Standing Committee on Community Development, Housing, and Economic Development.

Reauthorization of the Community Development Block Grant and Urban Development Action Grant programs are two of the very highest priorities for the U.S. Conference of Mayors this year. Since its inception in 1974, CDBG has proven to be one of the most efficient, popular, and effective vehicles for providing targetted assistance ever enacted. It enjoys the whole-hearted support of cities around the country. We deeply appreciate the strong support this Committee and its members always have extended to CDBG and UDAG. We look forward to working with you to reauthorize it for another three years.

In preparation for this reauthorization process, I convened a special policy meeting of the U.S. Conference of Mayors on January 26, 1983, to consider a wide range of policy questions on CDBG and UDAG. Over 100 cities were represented at this meeting. The views I will share with you today reflect the consensus of that group as it met and considered these issues. In addition, I would like at this point to submit for the record copies of policy resolutions adopted by the Conference of Mayors in recent years on CDBG and UDAG as background information.

Let me touch on the main concerns we have in this reauthorization.

Funding Level

The Conference of Mayors supports a funding level for CDBG of at least $4.5 billion in FY84. This represents a $1 billion increase over the Administration's proposal. Continued additions of new entitlement jurisdictions in the program--up to 60 new recipients in FY83 alone--and the cuts suffered in the last two years from previously authorized levels are more than adequate justification for such an increase. We support modest future increases in the following two years to account for continued growth in participation and in inflation.

New Construction for Housing

The Conference of Mayors strongly opposes the Administration's proposal to add new construction of housing to the list of eligible activities. This matter was discussed at length during our January meeting. We believe that the CDBG program currently carries a broad enough range of activities, for which funding currently is inadequate, and oppose further broadening. Moreover, we believe that federal support for new housing construction ought to remain a separately authorized activity, with its own funding source. Adding this activity to CDBG infers that the need for newly constructed housing can be met within the budget constraints imposed on the CDBG program.

As you know, this is not so.

Lump Sum Drawdowns

We oppose the Administration's request for repeal of the lump sum drawdown provisions of the current law. We believe that this can be an effective tool to stimulate leveraging of private funds in rehabilitation. We understand that the Administration is concerned that some abuses may have taken place in the use of this option. If so, we recommend that the HUD seek out those communities and resolve the issue. Abolishing the option because some have abused it is not sound federal policy.

Repeal of Section 312

Once again, the Administration proposes to repeal the Section 312 rehabilitation loan program and liquidate its assets. We continue to believe that the Congress should allow the use of recaptured funds in this program to continue to be spent on rehabilitation activities.

Repeal of Section 108 Loan Guarantees

We strongly oppose the proposed repeal of the Section 108 Loan Guarantee program. Last year we submitted a survey to this Committee summarizing the uses cities have made of this innovative option. In the last fiscal year, applications for loan guarantees jumped significantly as entitlement cities leveraged their CDBG grants for economic development and housing investment. The provision should be kept at least at its current $225 million level.

Public Services

Under the current legislation, all cities in the CDBG program must come down to the 10 percent cap on public services contained in the 1981 Omnibus Reconciliation Act. Starting in FY1984, waivers to this cap will no longer be available. Since 1981, 73 communities, including my own, have sought and received waivers from this cap. This is about 10 percent of the total entitlement universe. The Conference of Mayors supports the overall cap on public services. At our January 26 meeting, the overwhelming consensus of the cities was to maintain this as an appropriate indication of the focus on physical development which always has characterized the basic CDBG program. However, the cities also believe that those communities which have been granted waivers to exceed this limit based on historically higher levels should be permitted to continue at these higher rates at their own discretion. Conference of Mayors staff has submitted suggested language to accomplish this to the Subcommittee staff, and we urge your support of this change in the law.

URBAN DEVELOPMENT ACTION GRANTS

As part of its budget reduction strategy, the Administration has proposed reducing the authorization for Urban Development Action Grants (UDAG) to $196 million in FY84, or a 55 percent reduction from FY83 levels. As you know, the Congress has given every indication that it plans to reject the Administration's request to defer $244 million in FY83 funding to make up for its reduced authorization request. In light of this, we urge you to authorize UDAG at a level at least equal to FY83. The Conference of Mayors supports a higher level, at least $500 million, which is the level originally authorized in the 1981 Reconciliation Act.

The Administration also has proposed to shift entitlement cities which do not have at least 50,000 in population into the so-called "Small Cities UDAG" pot in FY84. The apparent reason for this shift is to provide a broader base of cities to absorb what amounts to a significant carry-over of funds in the Small Cities effort.

We oppose this shift.

Instead, we believe the Administration should propose and undertake a program of technical assistance to smaller communities to enable them to compete effectively for UDAGs. The inclusion of the additional central cities undermines the present, generally agreed upon breakdown between entitlement and non-entitlement jurisdictions. It would, in effect, create two classes of small cities for UDAG purposes: one group which has a continuing, federally supported community development capacity through entitlement grants, and the other which must rely wholly on a state administered program to provide the basic CDBG funding which can be so critical in supporting a UDAG application effort.

This proposal will not solve the fundamental problems facing the vast majority of small cities--continuing lack of capacity to prepare and present viable UDAG proposals, and a serious problem in attracting private investment into nonmetropolitan areas in amounts sufficient to satisfy UDAG criteria. We believe that the Committee should direct HUD to examine in greater detail the problems creating this carry-over. HUD should propose to the Committee a reasonable program to overcome these problems. Their current proposal simply would mask over the problem.

HOUSING ASSISTANCE PROGRAMS

The Conference of Mayors strongly supports the passage of new legislation authorizing housing assistance programs for the coming decade. The failure of both the House and the Senate last year to reach agreement on a new generation of programs to replace Section

8 has left the assisted housing tool chest practically bare. This will be reflected in coming years in a substantial drop in the number of new starts in multifamily housing, and in a significant reduction in the number of new occupancies in assisted housing. It is vital that the Congress move quickly to replace the programs of the past.

The Conference of Mayors urges the Committee to maintain a balanced approach to the question of housing assistance. We do not believe, as the Administration does, that providing assistance through existing housing resources is the only necessary course of action. We continue to support an approach which would provide housing assistance through Section 202, the conventional public housing program, and the Existing housing effort of Section 8. In addition, we believe that the time has come for the Congress to adopt a new program to assist in the development of new and rehabilitated multifamily rental housing.

Last year this Committee undertook a serious effort to forge a new production program. While we did not agree with every detail of this bipartisan effort, we feel that S.2607 was a substantial improvement over the Administration's proposals. We strongly support the central role given to local and state governments in the Senate Committee proposal. We also support the flexibility to undertake new construction, as well as rehabilitation, which the bill provided recipients of the funds. On the down side, we believe that the program in S.2607 is unnecessarily restricted in many ways, particularly in the rehabilitation section, and that the funding provided is wholly inadequate.

As you know, the Conference of Mayors for some time has supported a "block grant" approach to housing assistance, linked with continuing support for the Section 8 existing housing program to provide long-term income subsidies in housing. The cardinal tenets of our approach can be summarized as follows:

- Sufficient funds to make the program workable in a broad range of localities--at least $1 billion in contract authority.
- Certainty of funding levels for the primary recipients, especially cities. Localities must know how much they reasonably can expect to get in the program in order to justify the tremendous staff investment that participation would entail.
- Allocate the funds based on housing need.
- Maintain a diversity of production mechanisms. There should continue to be a role for HUD, for state housing finance agencies, and states, as well as for cities.

- Permit maximum flexibility in the use of the funds. Don't try to tell cities how to make housing production take place, or where.

- A substantial portion of the funds must be set aside for production or rehabilitation of units for low- and moderate-income persons.

The Conference of Mayors will work with all members of the Committee to try to create a workable housing program that will meet our needs. Time is short, but the time is now. We must move forward with a new production vehicle in this session of Congress.

Public Housing

The Administration is proposing a radical restructuring of the public housing operating and modernization funding systems. We are very concerned about these proposals. First, we are concerned that the specific formula changes proposed will leave some major public housing authorities without sufficient funds to manage their properties. We have no objection in principle to changes in the formula. However, the Administration has not shared these new formula elements with us for review. What we do know about them concerns us. We urge the Committee to scrutinize these changes carefully, and to direct the Department not to carry them out without explicit congressional approval.

The Administration also proposes to terminate the modernization program after a "transition period" and replace it with a yearly "replacement reserve" added onto the operating subsidy payment. We are very concerned about this approach. The current modernization program reflects the refinancing approach most private sector housing owners use to upgrade aging properties. Major work is capitalized over the expected life of the improvements. Work is undertaken when it is necessary. To promise authorities that these funds will be parceled out in small lumps over a long period of time, and kept in some kind of escrow at the local level is dangerous. It subjects all modernization programming to the vagaries of an annual appropriation process where the long-term effects of short-changing a capital account in one or more years is not readily apparent until the funds are needed in the distant future.

We already know that capital investment is the first thing to be sacrificed when budgets are tight. All around us, we see the evidence of underfunding in our basic urban infrastructure. Do not throw away a vehicle designed to encourage reinvestment in a major infrastructure element--our existing assisted housing.

Finally, the Administration is proposing a series of changes in the continuing housing assistance programs. We are extremely concerned about the likely effects of their proposed changes to the Section 8 Certificate program. Last year we submitted to the Congress a report prepared by City of Seattle staff which showed the effects of this change would be there on the existing Section 8 tenancy. We have included this again. In brief, families would be severely affected, and probably suffer significant rent increases as a result. We cannot support a proposal which has this demonstrable effect.

For the same reason, we strongly oppose the Administration's proposal to count as income for housing purposes the value of food stamps received by tenants. This will hurt the poorest and the elderly the most. It cannot be justified and it should be rejected, as it was by a bipartisan vote in the last Congress.

Mr. Chairman, members of the Committee, thank you again for this opportunity to share our views on these vital issues. I will be happy to answer any questions you may have.

Senator TOWER. We will be delighted to place those in the recor

[The information follows:]

ANALYSIS OF PROPOSED CHANGES IN THE FEDERAL SECTION 8 EXISTING PROGRAM

Lanny Shuman
Office of Management and Budget
City of Seattle
April 1, 1982

SUMMARY

The President's FY 1983 budget proposes a dramatic shift in the way HUD provides housing assistance. The budget calls for the virtual elimination of new construction and rehabilitation programs in favor of a modified Section 8 Existing program. In FY '83 over 90 percent of all new direct rental housing assistance would be supplied through privately owned existing housing compared with less than 20 percent in FY '80.

The FY 1982 budget raised tenant contributions from 25 percent of income to 30 percent for all Section 8 programs. The FY '83 budget assumes a number of changes in the Section 8 Existing program itself. The program would no longer limit recipients to units with rents less than Fair Market rents. Recipients would live in any decent housing regardless of rent levels, but would receive a housing allowance based on a new rent standard. A number of other changes are designed to reduce the eligible populations and to increase the amount that program participants pay:

- requiring that food stamps be counted as income.
- reduction in program eligibility from 80 percent to 50 percent of median income.
- elimination of annual assistance increases increases to compensate for inflation in housing costs.

First year impacts of these changes on Seattle's program vary. The FY '82 increase in required tenant participation will be "phased in" over 5 years and the first year impact will be small. The elimination of Fair Market rents will actually benefit some Seattle recipients, those whose total housing costs are below the new rent standards. These gains would be more than offset by the change requiring food stamps to be counted as income and by the increase in tenant participation. The average decrease in housing assistance in the first year would be about $40 per month for each assisted household.

Longer term impacts are more difficult to predict. The elimination of annual increases in assistance to compensate for inflation will mean that the value of the assistance payment will be seriously eroded: Average monthly rents could increase by $100 to $200 over a five year period with no change in assistance.

The purpose of this paper is to explain the changes in HUD's Section 8 Existing program and how the changes will affect the Seattle area housing assistance recipients. The paper summarizes the changes in federal funding of housing programs; compares the current Section 8 Existing program with the proposed modified program; and quantifies the specific impacts of the program changes on Seattle recipients.

CHANGES IN FEDERAL HOUSING ASSISTANCE

The President's proposed FY1982 rescissions and FY 1983 budget shift federal housing efforts almost exclusively into assistance to tenants in existing housing, virtually eliminate the New Construction and Substantial Rehabilitation Programs (with the exception of the Section 8/202 program), and increase the amounts that housing assistance recipients must contribute toward their rents. The following table shows the changes in the major HUD housing programs from 1980 to 1983, and the proportion each program represents of total new federally assisted units for the year.

Numbers of Newly Assisted Housing Units Funded
by Major HUD Housing Programs - 1980-83

Program	FY80	FY81	Proposed FY82[1]	Proposed FY83
Section 8 Existing	47,022 19.6%	85,289 38.7%	186,385 84.8%	5,000 4.1%
Modified Section 8 Existing ("vouchers")	-	-	-	106,615[2] 87.7%
Section 8/202	20,440 8.5%	15,166 6.9%	16,933 7.7%	10,000 8.2%
Section 8 New Construction/Moderate Rehab	94,758 39.4%	58,69[illegible] 26.6%	5,569 2.5%	0 0.0%
Section 8 Moderate Rehabilitation	40,000 16.6%	24,981 11.3%	10,720 4.9%	0 0.0%
Public Housing	38,172 15.9%	36,370 16.5%	310 0.1%	0 0.0%
Total, All Programs	240,392 100.0%	220,501 100.0%	219,917 100.0%	121,615 100.0%

The 1983 Housing assistance programs rely heavily on a modified form of the Section 8 Existing program, sometimes called the "voucher" program. Note that in 1980 only about a fifth of newly assisted units were provided through the the use of existing housing, while over 90% of newly assisted units proposed in the FY83 program would be provided with existing housing.

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[1] This column incorporates changes in the FY 1982 budget proposed in the FY 83 budget.

[2] While these units are classified as "newly assisted," in fact 60,615 of the units would be used to buy out obligations under the current certificate program, and the remaining units will be used in conjunction with the Rental Rehabilitation Progam and with the sale of HUD owned properites.

The assistance payments would not go up with higher rents or down with lower rents. If an assistance recipient chose to rent very expensive housing, the additional costs would come out of his/her pocket. Conversly, finding housing cheaper than the Standard Rent would accrue benifit to the recipient.

In addition, HUD is proposing elimination of inflation adjustments. Vouchers would be good for five years at the assistance level determined in the first year of participation. Under the current program assistance payments are adjusted each year to reflect changing rent levels.

The following table compares major aspects of the current and proposed programs and shows the Seattle area 1981 Fair Market Rents, estimated Standard Rents and income eligibility levels. For comparative purposes the Standard Rents have been estimated as if they had been implemented in 1981. The actual Standard Rents, when they are finally implemented by HUD, will also be adjusted upward to account for inflation.

Proposed Modifications: Section 8 Existing Program

	Current System- Section 8 Existing Program	Proposed System- Modified Section 8 Existing or "Vouchers"
Eligibility	Families, elderly, and handicapped below the 80% of median income standard (lidded in Seattle at 69.7%). Standards for the Seattle area are: 1 person $1271/month 2 persons $1450 3 persons $1629 4 persons $1813 5 persons $1925	Families, elderly, and handicapped below the 50% of median income standard, including food stamps. The 1981 standards for the Seattle area would be: 1 person $ 908/month 2 persons $1042 3 persons $1171 4 persons $1300 5 persons $1404
Household contribution	25% of adjusted gross income (i.e., after deductions of excess medical expenses and of $300 per child). The 25% includes an approved allowance for utilities. Congress has already approved the increase to 30%.	30% of adjusted gross income for new participants. The 5% increase will be phased in over the next 5 years for current recipients, i.e., 26% the first year, 27% the second, and so on. Again, income will now include food stamps.
Rental Assistance level	HUD pays the difference between the required household contribution and the total of the housing unit contract rent and a utilities allowance. This total cannot exceed the Fair Market Rent.	HUD pays the difference between the household contribution and a new "Standard Rent" for the size unit the household qualifies for. The assistance payment will be this difference regardless of the actual total expenses for the unit

SECTION 8 EXISTING HOUSING: PROPOSED CHANGES

The new program, explained in detail below, represents a number of shifts in the way HUD provides assisted housing:

> HUD will provide most housing assistance through existing housing units, relying on the private housing market, partially in response to the demand created by the HUD programs themselves, to provide new and substantially rehabilitated housing.*
>
> Housing assistance recipients will now be allowed to live in any housing they choose regardless of the rent (so long as it is not substandard housing). Assistance payments will be based on a "standard rent" and will not vary with the actual rent tenants pay. This program change will provide participants a reason to seek out the least expensive housing.
>
> HUD will reduce the amount of assistance provided to each household. Recipient households now are required to pay 25% of their incomes for rent. This maximum contribution will soon be changed to 30% although current participants will be "phased in" over a 5 year period. The new program will also require that food stamps be counted as income and will eliminate HUD paying for utilities in cases where utilites bills exceed the maximum household contribution.
>
> The modified certificates will be good for only five years at the same assistance level as the original year of application. There will be no annual adjustments for inflationary increases in rent levels.

Current Program: Under the Section 8 Existing program, housing assistance recipients pay a maximum of 25% of their adjusted gross income (after deductions for children and excess medical expenses). The 25% maximum also includes an allowance for utilities. There are more generous provisions for very large, very low income households, but these cases represent a very small part of assisted households. Eligible households are those whose incomes are under a set of income limits set by HUD. The income limit for a family of four is 80% of the area median income; this limit is adjusted for different household sizes. (The actual limit in the Seattle-Everett area is 69.7% of median income because of "lidding" of the limit in higher income areas such as Seattle.)

Eligible housing units are "decent, safe, and sanitary" housing units, generally units in good condition which have both bathroom and kitchen facilities and meet other HUD size standards. Rent for the units must be less than Fair Market Rents for the area. Fair Market Rents are rents determined by HUD to be the median (50th percentile) rents for qualifying housing in the area, excluding new units.

Proposed Program: A number of major modifications to the Section 8 Existing program have been proposed for implementation in FY1983 or sooner. Income eligibility limits for the program would be reduced from the current 80% standards to 50% of the median income. HUD is proposing that a new set of "Standard Rents" be used for determining the level of assistance to a recipient household. The standard rent would be the 40th percentile area rent level for housing units of each size, excluding new units. All "decent, safe, and sanitary" housing units would be eligible, regardless of rent levels. Assistance payments would the difference between 30% of adjusted gross income and the standard rent.

*Evidence from the Experimental Housing Allowance Program indicates that the market does not respond this way.

	Current System-Section 8 Existing Program	Proposed System- Modified Section 8 Existing or "Vouchers"
Rent levels	Fair Market Rents: These rent levels are 50th percentile rents for rental units in the region. The total of contract rents and utilities in assisted units cannot exceed these levels. Seattle-Everett area Fair Market Rents for 1981 are: 0 bedroom $274 1 bedrooms $334 2 bedrooms $394 3 bedrooms $493 4 bedrooms $539	Standard Rents: These rents are the 40th percentile of rents for units in the region. (Again, the rents include utilites costs.) Their purpose is only to determine the level of assistance for each certificate. Estimated Standard Rents for the Seattle-Everett area for 1981 are: 0 bedroom $248 1 bedrooms $303 2 bedrooms $357 3 bedrooms $447 4 bedrooms $488
Eligible housing units	"Decent, safe and sanitary" housing units with rents at or below Fair Market Rents. HUD Area Offices may exceed FMR's by up to 20% in certain circumstances.	Any "decent, safe and sanitary" housing unit. Participants may rent any price unit they wish, but additional rent above the standard rent will be paid by the tenant. Conversly, rent savings realized by renting a unit below the standard will accrue to the tenant.
Inflation adjustments	Certificates are updated annually using new participant incomes, contract rents, and Fair Market Rents	Certificates would be good for 5 years with no increase in the assistance payment. (Periodic inflation adjustments in the standard rents would apply to new participants only.)

LOCAL IMPACTS

There are a total of 9379 households in Seattle receiving direct rental assistance under various HUD programs. Of these, 1957 hold certificates under the Section 8 Existing program administered by the Seattle Housing Authority. The estimated "universe" of HUD Section 8 units* in Seattle is as follows:

	Elderly/ Handicapped	Families	All Sec 8 Assistance
SHA owned public housing	3959	1891	5850
Section 8 Existing (privately owned	881	1076	1957
Other Section 8	1426	146	1572
Total	6266	3113	9379

*Does not include 2078 units with direct rental assistance payments under the Rent Supplement Program. Most of these units are for elderly and handicapped persons.

It is the impact on the 1957 households in the Section 8 Existing program with which we are concerned. The following table shows the estimated income distribution among the households in this group.

Estimated Income Levels, Current Certificate Holders

Income level expressed as a % of median income	Elderly/ Handicapped		Families		Total, All Households	
	number	%	number	%	number	%
0% to 20%	479	54.4%	631	58.7%	1110	56.7%
20% to 30%	249	28.3%	196	18.2%	445	22.7%
30% to 40%	80	9.1%	107	9.9%	187	9.6%
40% to 50%	63	7.1%	107	9.9%	170	8.7%
50% to 80%	10	1.1%	35	3.3%	45	2.3%
All income groups	881	100.0%	1076	100.0%	1957	100.0%

Note: Estimates based on 10% sample of current certificate holders.

It is HUD's intent eventually to replace the current Section 8 Existing certificates with the new modified certificates. The following are assessments of the major changes in the program: the increased percentage of income that HUD is requiring participant households to pay (proposed for "phase in" over the next five years for current participants); the change in income eligibility from the 80% of median income based standard to a 50% based standard; the inclusion of food stamps for the purpose of determining the level of benefits; the elimination of a utilities allowance; and the implimentation of "standard rents" (replacing Fair Market Rents). The total impact of the changes is also assesed and summarized in a table on the last page. No attempt has been made to assess the long term impact of the elimination of an annual inflation adjustment.

Increased household contribution: The household contribution in Section 8 programs has historically been 25% of adjusted household income. As part of the FY 1982 budget, the tenant contribution was shifted to 30% of adjusted income. Regulations have not yet been issued to implement this change, but it is HUD's intent to phase in the new participation rate for current certificate holders, probably increasing the requirement by one percentage point per year. The total impact, i.e., making the change in one year, would increase the amount the average Seattle participant would pay by $23 per month; the first year impact would be an increase of a little less than $5 per month. (See summary table below for impacts on elderly, handicapped, and families.)

Income eligibility changes: Reduction of the income eligibility from the current standard to the 50% of median income standard will have little impact on Seattle certificate holders. Only about 2% of current Seattle certificate holders have incomes higher than the very low-income standard. The change would thus make about 45 households ineligible for assistance under the new system. Over three quarters of the households eliminated are non-elderly families.

Food stamps as income: The more serious impact on Seattle certificate holders is the proposed inclusion of food stamps as income. While no data on food stamp program participation was available in the sample, virtually all certificate holders are eligible. The average household coupon value for Public Assistance recipients is $105.46. Since housing assistance recipients are required to pay 30% of their incomes for rent, on the average, certificate holders will pay about $27 per month more in rent the first year of the "phase in", and eventually would pay about $32 per month more.

Standard Rent Implementation: Under the current program, recipients pay the difference between the required household contribution and the total of the contract rent and utilities allowance. This total is limited by Fair Market Rents. Under the proposed program, the assistance payment is the difference between the required household contribution and a new "standard rent", regardless of the level of the actual contract rent. Standard rents are to be defined as the 40th percentile of the same set of rental units and will thus be slighly lower rents for the same size units. In the Seattle-Everett area, 40th percentile rents are about 91% of 50th percentile rents.

Under the current system, the assistance level is the difference between the required household contribution and the total of the contract rent and the utilities allowance. The proposed program has an important provision: assistance recipients will receive the diffencenc between their required contribution and the standard rent for their unit size regardless of the level of actual rent or utilities costs. Thus, certificate holders whose actual rent and utilities are less than the new standard rent would gain from this change, and those who pay more would lose. Implementation of this change in 1981 would have resulted in an average loss in assistance of about $8 per month. Note that this change, in and of itself, would actually increase assistance to elderly and handicapped households while decreasing assistance to non-elderly households. (See table below.)

Total impacts: The table on the next page summarizes the losses and gains attributable to each program change. Note that the impacts of the changes in the household contribution requirement and in the income definition have been shown for one year only.

HUD has estimated that annual per unit costs of the Section 8 program will be reduced from about $3200 to about $2000. This appears to be inconsistant with the estimated impacts on Seattle recipients: Total savings per unit in Seattle appear to be only about $40 per month or about $480 per year per unit for the first year.

The long term impacts, of course, will be more severe. At the end of the 5-year "phase in" average assistance payments will have fallen another $22.62. Even this loss understates the real loss since program recipients will undoubtedly be paying much higher rents. Inflation in rent levels could increase average rents in the program by $100 to $200 per month per unit.

The analysis of impacts of the proposed program modifications is based on Standard Rent estimates for FY 1981. The estimates were made using 1981 Fair Market Rents (FMR's) and preliminary HUD estimates of the ratio between 50th and 40th percentile rents in the Seattle-Everett SMSA. Again, the Standard Rent estimates were made for 1981 in order to calculate the estimated impacts using 1981 program recipient data (incomes, contract rents, assistance payments, etc). The Standard Rent estimates are not predictions of those HUD will promulgate for the actual program. HUD will include an inflation factor in calculating the new rent schedule.

Summary of Estimated Impacts On Monthly Assistance
Payments to Section 8 Existing Certificate Holders

	Elderly	Handicapped	Families	All Hslds
Average Assistance Payment, 1981	$173.78	$209.30	$294.32	$245.73
Changes in Program:				
o Change from 25% to 26% of income (1st year of "phase in")	-$4.20	-$3.60	-$5.10	-$4.60
o Change from Fair Market Rents to "standard rents"	+$14.55	+$8.10	-$24.47	-$7.96
o Requiring food stamps to be counted as income (1st year impact)	(Information not available for each household type)			-$27.40
Total Impact, 1st Year Only	?	?	?	-$39.96
Estimated 1981 Assistance Payment Under Revised Program				$205.77

Community Development Block Grants and Federalism

WHEREAS, the Community Development Block Grant (CDBG) and Urban Development Action Grant (UDAG) programs have operated since 1974, and were developed in close cooperation with local governments; and

WHEREAS, the CDBG and UDAG programs provide flexible assistance to communities based on distress and need, with a minimum of red tape and administrative delay; and

WHEREAS, CDBG and UDAG funds are proven, effective tools for local governments to eliminate or prevent slums and blight; to assist low- and moderate-income persons; to meet urgent community needs; to create and retain private sector jobs; and to strengthen and revitalize neighborhoods and housing; and

WHEREAS, there have been proposals to fold CDBG and UDAG into a "super block grant" administered by state government with a limited commitment of federal assistance,

NOW, THEREFORE, BE IT RESOLVED that the U.S. Conference of Mayors reaffirms its strong belief that CDBG and UDAG are excellent examples of functioning federalism and should be maintained in their present form; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors reaffirms its belief that the goals of the CDBG and UDAG programs are legitimate national goals which should continue to be supported by the federal government; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors rejects proposals that such community development goals are more properly the business of state government, without any federal role; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors opposes any proposals to shift CDBG and UDAG from their present direct federal-city model, specifically opposes folding CDBG and UDAG into a larger, "super block grant" as proposed earlier this year, and directs the Conference of Mayors staff to work with Congress and the Administration to ensure the continuation of the CDBG and UDAG programs in their present form.

National Housing Policy and Federalism

WHEREAS, the decade of the 1970's saw a steady increase in housing costs of all kinds, as shown by the following statistics:

- median income for homeowners increased by 89 percent, while median value of a home rose by 175 percent;
- rents during the decade rose by 125 percent, and total expenses for homeowners rose by 112 percent, while household incomes grew by only 98 percent during the same period; and

WHEREAS, developments in the housing area have affected the lower income family and individual particularly hard, as shown by the following statistics:

- while the number of renters with incomes below $3,000 per year dropped by about one-half to 2.9 million during the 1970's, the number of rental units available to them at rents at or below 30 percent of income fell by 75 percent, to less than 1.5 million;
- while median rents for all renters rose by 21 percent from 1978–1980, median rents for those with incomes below $3,000 per year income rose by 38 percent;
- while the proportion of income spent for shelter for all income groups rose, the median was 25 percent of income or more *only* for those earning $15,000 per year or less; and
- of the 2.9 million households with incomes below $3,000, only about 19 percent lived in subsidized housing; 51 percent were in households with two or more people; 13 percent were married couples and 27 percent had children of their own under 18; 59 percent paid more than 60 percent of their income for rent; and 46 percent lived in central cities; and

WHEREAS, the U.S. Conference of Mayors has supported an all-incomes housing policy with a particular emphasis on serving the needs of lower income persons; and

WHEREAS, budget cuts enacted by the Congress in FY82 reduced federal assistance for low income housing by almost 50 percent, providing less than 150,000 units of assistance for lower income persons, and proposed reductions through rescissions in FY82 would reduce this by another 50 percent; and

WHEREAS, proposed budget levels for assisted housing in FY83 would provide no new additional budget authority for assisted housing of any kind for the first time in four decades; and

WHEREAS, other budget cuts enacted by the Congress and proposed for FY83 have substantially restricted funds available to local and state governments to provide services to lower income people on any terms, and the worsening economy has created increased pressures to serve the needy in cities; and

WHEREAS, the U.S. Conference of Mayors believes that only the federal government, through a progressive system of taxation, can generate the revenues necessary to ensure equitable treatment for lower income people in need of housing assistance across the country; and

WHEREAS, the U.S. Conference of Mayors opposes shifting the burden of financing necessary programs of housing assistance through local tax systems, especially through sales and property taxes, which fall most heavily on those with modest incomes,

NOW, THEREFORE, BE IT RESOLVED that the U.S. Conference of Mayors, reaffirms its strong support for a continued major federal role in the development, operation, and financing of housing assistance for lower income people; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors calls on the Congress to reject further cuts in federally assisted housing budgets, and to maintain at least the same level of funding in FY83 as approved in Appropriations Acts in 1981 for HUD's assisted housing programs; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors supports reforms in the administration of federal housing assistance which place greater reliance on local government involvement in the allocation and use of funds to meet local priorities and urges the Administration to provide maximum practicable flexibility to local governments in the use of housing assistance funds allocated to cities, but reaffirms its strong belief that responsibility for providing housing assistance to lower income people cannot be successfully devolved onto state or local governments without continuing, substantial, and adequate funding assistance from the federal level to operate such programs; and

BE IT FURTHER RESOLVED that the U.S. Conference of Mayors reaffirms its support for an all-incomes housing policy, but rejects national policies which provide assistance for one sector of the housing economy without adequately providing for others, particularly lower income people; and

BE IT FURTHER RESOLVED that while the U.S. Conference of Mayors believes that regulatory reform at the local level should be pursued and can help reduce housing cost somewhat, that an overall reinvigoration of the housing economy is dependent upon continued federal support for an all-incomes housing policy and a reduction in interest rates for housing.

Senator **Tower**. Senator Riegle.

Senator **Riegle**. Mr. Chairman.

First, I want to thank you for that good statement, one that I found myself in substantial agreement with. There are some sharp differences of opinion, both in terms of national spending priorities as well as the proposed repackaging and reshuffling of responsibilities that have been proposed by the Reagan administration.

I find myself in substantial agreement with your comments. So I think I will forbear on questions right now.

The chairman may have things that he wants to raise with you.

Senator **Tower**. Let's go ahead and hear from Mr. Scott, representing the National Association of Counties, and the county supervisor from Fairfax.

JIM SCOTT, COUNTY SUPERVISOR, FAIRFAX, VA., REPRESENTING NATIONAL ASSOCIATION OF COUNTIES

Mr. **Scott**. Thank you, Mr. Chairman.

Representing NACO, I am pleased to be here again. I am Jim Scott, from Fairfax, Va., and chairman of the NACO Community Development Steering Committee.

At our annual legislative conference—a couple of weeks ago, I guess now—I am happy to report that our membership gave a strong affirmation for the need to reauthorize the community development block grant program and the assisted housing programs.

We are, of course, acutely aware that there are important budget constraints facing you, and I need not point out to you, Mr. Chairman, that housing has absorbed drastic cuts in funding and that the block grant program has been held constant during the last few years in response to budget problems.

As a result, there has been a steady erosion of dollars. In addition, there has been some folding in of additional programs into the CD program.

These things, along with the severe cuts already taken in housing, make it imperative that the CD and housing programs be authorized at at least their current levels and that some consideration be given to increasing the authorization level to the CDBG program to about $4.2 billion.

Because of the counties' particular need for planning and because we are required to have our constituent units of government sign into the program for a 3-year period, we would like very much to have the CD program reauthorized for at least 3 years.

NEW FEDERALISM PROPOSAL

Mr. Chairman, we were asked to address the New Federalism proposal. NACO is trying to still review the administration proposal and has no specific position yet on the two block grant proposals which would affect CD.

However, the members of our steering committee of our Community Development Steering Committee have discussed it, and I can report to you some concerns expressed on a number of issues.

First, there is some very grave concern about the blending of CD and general revenue sharing because the purposes and objectives of the programs we think are quite different.

Second, there is already a great deal of discretion in the two programs within the context of their purposes. Further, there is no long-term funding available for these programs to insure their continuation beyond the reauthorization period.

It's really questionable, we think, that local budgets will be able to finance the diverse neighborhood, economic, development, senior citizen, housing and infrastructure projects made possible through community development block grant funding.

Finally, a very important point. The urban counties have an administrative complication presented by the proposal. Counties receive general revenue sharing as a separate entity; they receive their CDBG entitlement, however, as a "construct" of their cooperating jurisdictions.

If the funds are made available as a single block grant, questions would arise as to whether the funds would have to be passed through to the local units of government, or if the expenditure of funds would be limited to the participating cities and towns.

If this is the case, the county community development programs could effectively be dismantled and counties would lose their discretion rather than enhance it.

Despite the fact—moving now to the UDAG program— that only 14 counties are eligible for UDAG, NACo has consistently supported its reauthorization.

We are concerned that the unspent portion of the small cities program has become a target for budget cutting. We believe that the experience and professional expertise of a county planning and development staff could be helpful in assisting small cities within a county in packaging and administering a UDAG program.

There has been some experience already in this regard. I draw your attention to Riverside, Calif., where the city of Coachella has worked with the county. We would like to see small counties eligible for the small cities UDAG funds. We really can't see any reason why counties are ineligible now.

Finally, although urban counties are eligible in the UDAG pockets of poverty program, the existing qualification requirements make it extremely difficult for them to participate in the program.

As we mentioned, we only have 14. We'd like to work with the committee in suggesting possible changes in the program requirements that would recognize the particular needs of counties with pockets of poverty which may not be as large as the current minimum requirements.

NACo is deeply concerned about the administration's budget request for low-income housing assistance. As you know, it proposes a deferral of $3.1 billion from 1983 and only $514 million in new budget authority.

We strongly urge the committee to set the fiscal year 1984 budget authority at least at the level recommended last year: 17.4. We further oppose the near elimination of new low-income housing construction and support a mix of both new construction and existing housing.

SUPPORT CONCEPT OF RENTAL REHAB

We support the concept of a rental rehab and development grant. We think that urban counties should be direct recipients under a formula allocation. We do find a minimum allocation to be acceptable. Because local housing shortages, surpluses and conditions differ throughout the country, we think that block grants should be available for both rehab and new construction at the discretion of the city or county.

We support the use of funds for loans and grants in low-income areas and urge that funds be available to assist low- and moderate-income households in nonconcentrated areas as well. It's particularly important in counties where the county's low-income population is usually dispersed.

We strongly oppose the administration's proposal that new housing construction be made an eligible CDBG activity. The demands on the limited CDBG funds are already great and the addition of a new activity as costly as new construction would only serve to drain the community development block grant resources.

We support the concept of housing vouchers or certificates; however, we do not support program changes which would make that housing less affordable to low-income persons such as counting food stamps as income or requiring certificate holders to pay utilities.

Finally, we urge the continuation of the 108 loan guarantee program which has become a useful CD tool for counties. As an illustration, let me describe how we've used it in my county. Perhaps some on the committee are familiar with our mobile home park along Route 1 just outside of Alexandria, Va. This park was crowded, dilapidated, and outdated.

We are now redeveloping it as a result of our CD program. It's costly, it's difficult, but we are working with the community in the surrounding area—and the rehab of this existing old mobile home park was only possible through the 108 program and a $3.5 million loan guarantee.

In closing, Mr. Chairman, I'd like very much to thank you and the members of the subcommittee for the opportunity to present the views of the National Association of Counties. We know you will consider them seriously and we look forward to working with you on these issues in the future.

Thank you.

[The complete statement follows:]

STATEMENT BY THE HONORABLE JIM SCOTT, SUPERVISOR, FAIRFAX COUNTY, VIRGINIA ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES, BEFORE THE SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS, ON THE REAUTHORIZATION OF COMMUNITY DEVELOPMENT AND HOUSING PROGRAMS, MARCH 9, 1983, WASHINGTON, D. C.

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO AGAIN BE TESTIFYING BEFORE THIS SUBCOMMITTEE ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo)*. I AM JIM SCOTT, A COUNTY SUPERVISOR FROM FAIRFAX COUNTY, VIRGINIA, AND CHAIRMAN OF THE COMMUNITY DEVELOPMENT STEERING COMMITTEE OF THE NATIONAL ASSOCIATION OF COUNTIES.

JUST LAST WEEK, NACo CONDUCTED OUR ANNUAL LEGISLATIVE CONFERENCE AND I BRING TO YOU FROM OUR MEMBERSHIP A STRONG AFFIRMATION OF THE NEED TO REAUTHORIZE THE COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) AND ASSISTED HOUSING PROGRAMS.

BELIEVE ME, MR. CHAIRMAN, WE ARE ACUTELY AWARE OF THE BUDGET CONSTRAINTS FACING YOU IN VIEW OF THE NATIONAL DEFICIT. I NEED NOT POINT OUT TO YOU THAT HOUSING HAS ABSORBED DRASTIC CUTS IN FUNDING AND THE BLOCK GRANT PROGRAM HAS BEEN HELD CONSTANT THE LAST TWO YEARS IN RESPONSE TO THE BUDGET PROBLEMS. THERE HAS BEEN A STEADY EROSION IN THE REAL EFFECT OF CDBG DOLLARS. THIS IS DUE TO INFLATION, THE FOLD-IN OF NUMEROUS OTHER CATEGORICAL PROGRAMS, AND THE INCREASING DEMANDS ON THE PROGRAM DUE TO UNEMPLOYMENT AND A DETERIORATING INFRASTRUCTURE. THIS, ALONG WITH THE SEVERE CUTS ALREADY TAKEN IN HOUSING MAKE IT IMPERATIVE THAT THE CDBG AND HOUSING PROGRAMS BE REAUTHORIZED AT LEAST AT THEIR CURRENT LEVELS

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* The National Association of Counties is the only national organization representing county government in the United States. Through its membership, urban, suburban and rural counties join together to build effective, responsive county government. The goals of the organization are to: improve county government; serve as a liaison between the nation's counties and other levels of government; achieve public understanding of the role of the counties in the federal system.

AND THAT SOME SERIOUS CONSIDERATION BE GIVEN TO INCREASING THE FUNDING LEVEL FOR CDBG TO $4.2 BILLION. IN ADDITION, CDBG SHOULD BE REAUTHORIZED FOR AT LEAST THREE YEARS. THIS IS IMPORTANT FOR URBAN COUNTIES SINCE WE ARE REQUIRED TO HAVE OUR CONSTITUENT UNITS OF GOVERNMENT SIGN INTO THE PROGRAM FOR A MINIMUM OF THREE YEARS.

IN INVITING US TO TESTIFY, YOU ASKED THAT WE ADDRESS AN ISSUE OVERLAYING THE CDBG PROGRAM, NAMELY, THE NEW FEDERALISM PROPOSAL. NACo IS STILL REVIEWING THE IMPACT OF THE ADMINISTRATION'S PROPOSAL AND HAS NO SPECIFIC POSITION ON THE TWO BLOCK GRANT PROPOSALS WHICH WOULD AFFECT CDBG.

RESULTING FROM INITIAL DISCUSSION WITH THE MEMBERS OF THE NACo COMMUNITY DEVELOPMENT STEERING COMMITTEE, HOWEVER I CAN CONVEY TO YOU CONCERN EXPRESSED RELATED TO A NUMBER OF ISSUES. FIRST, THE BLENDING OF CDBG AND GENERAL REVENUE SHARING COULD PRESENT SOME PROBLEMS SINCE THE PURPOSES AND OBJECTIVES OF THE TWO PROGRAMS ARE QUITE DIFFERENT. SECOND, THERE IS ALREADY A GREAT DEAL OF DISCRETION IN THESE TWO PROGRAMS WITHIN THE CONTEXT OF THEIR PURPOSES. FURTHER, THERE IS NO LONG TERM FUNDING SOURCE AVAILABLE FOR THESE PROGRAMS TO ENSURE THEIR CONTINUATION BEYOND THE REAUTHORIZATION PERIOD. IT IS UNQUESTIONABLE THAT LOCAL BUDGETS WOULD NEVER BE ABLE TO FINANCE THE DIVERSE NEIGHBORHOOD, ECONOMIC DEVELOPMENT, SENIOR CITIZEN, HOUSING, AND INFRASTRUCTURE PROJECTS MADE POSSIBLE THROUGH CDBG FUNDING. FINALLY, A POINT VERY IMPORTANT TO URBAN COUNTIES, IS AN ADMINISTRATIVE COMPLICATION PRESENTED BY THE PROPOSAL. COUNTIES RECEIVE GENERAL REVENUE SHARING AS A SEPARATE ENTITY. THEY RECEIVE THEIR CDBG ENTITLEMENT, HOWEVER, AS A "CONSTRUCT" OF COOPERATING JURISDICTIONS. IF THE FUNDS ARE MADE

AVAILABLE AS A SINGLE LOCAL BLOCK GRANT, QUESTIONS ARISE AS TO WHETHER THE FUNDS WOULD HAVE TO BE PASSED THROUGH TO THE LOCAL UNITS OF GOVERNMENT, OR IF THE EXPENDITURE OF FUNDS WOULD BE LIMITED TO THE PARTICIPATING CITIES AND TOWNS. IF THIS IS THE CASE, COUNTY COMMUNITY DEVELOPMENT PROGRAMS COULD EFFECTIVELY BE DISMANTLED AND COUNTIES WOULD LOSE DISCRETION RATHER THAN ENHANCE IT.

DESPITE THE FACT THAT ONLY 14 COUNTIES ARE ELIGIBLE FOR THE URBAN DEVELOPMENT ACTION GRANT (UDAG) PROGRAM, NACo HAS CONSISTENTLY SUPPORTED ITS REAUTHORIZATION. WE ARE CONCERNED THAT THE UNSPENT PORTION OF THE SMALL CITIES UDAG PROGRAM HAS BECOME A TARGET FOR BUDGET CUTTING. CLEARLY, HIGH INTEREST RATES HAVE BEEN AN IMPEDING FACTOR; HOWEVER, WE FEEL THAT THE EXPERIENCE AND PROFESSIONAL EXPERTISE OF A COUNTY PLANNING AND DEVELOPMENT STAFF COULD BE INSTRUMENTAL IN ASSISTING SMALL CITIES WITHIN A COUNTY IN PACKAGING AND ADMINISTERING A UDAG PROGRAM. FOR THIS REASON, WE ARE SUGGESTING THAT THE SUBCOMMITTEE CONSIDER ALLOWING COUNTIES TO ACT AS AN AGENT AT THE REQUEST OF A SMALL CITY IN APPLYING FOR AND ADMINISTERING A UDAG PROGRAM. COOPERATION AND ASSISTANCE OF THIS NATURE TO SMALL CITIES BY THEIR COUNTIES IS ALREADY TAKING PLACE. FOR EXAMPLE, IN RIVERSIDE COUNTY, CALIFORNIA, THE CITY OF COACHELLA (POPULATION: 8000) SUCCESSFULLY COMPETED ON ITS OWN FOR A SMALL CITIES UDAG. WHEN A KEY DEVELOPER ON THE PROJECT WITHDREW, THE CITY REQUESTED THE ASSISTANCE OF THE COUNTY, WHERE UPON THE COUNTY RENEGOTIATED AND REPACKAGED THE GRANT.

FURTHER, AND MORE IMPORTANTLY, WE SEE NO REASON WHY COUNTIES ARE INELIGIBLE TO APPLY FOR SMALL CITIES UDAG FUNDS AND WE URGE THE SUBCOMMITTEE TO CONSIDER EXTENDING ELIGIBILITY TO COUNTIES.

FINALLY, ALTHOUGH URBAN COUNTIES ARE ELIGIBLE FOR THE POCKETS OF POVERTY PROGRAM, THE EXISTING QUALIFICATION REQUIREMENTS MAKE IT EXTREMELY DIFFICULT FOR COUNTIES TO PARTICIPATE IN THE PROGRAM. WE WOULD LIKE TO WORK WITH THE COMMITTEE ON THIS ISSUE IN SUGGESTING POSSIBLE CHANGES TO THE PROGRAM REQUIREMENTS.

NACo IS DEEPLY CONCERNED ABOUT THE ADMINISTRATION'S BUDGET REQUEST FOR LOW INCOME HOUSING ASSISTANCE. AS YOU KNOW, IT PROPOSES A DEFERRAL OF $3.1 BILLION FROM 1983 AND ONLY $514 MILLION IN NEW BUDGET AUTHORITY. WE STRONGLY URGE THE COMMITTEE TO SET THE 1984 BUDGET AUTHORITY AT LEAST AT THE LEVEL RECOMMENDED LAST YEAR AT $17.4 BILLION. WE FURTHER OPPOSE THE NEAR ELIMINATION OF LOW INCOME HOUSING CONSTRUCTION AND SUPPORT A MIX OF BOTH NEW CONSTRUCTION AND EXISTING HOUSING.

WE SUPPORT THE CONCEPT OF A RENTAL REHABILITATION AND DEVELOPMENT GRANT. URBAN COUNTIES SHOULD BE DIRECT RECIPIENTS UNDER A FORMULA ALLOCATION. WE DO FIND A MINIMUM ALLOCATION TO BE ACCEPTABLE, HOWEVER. BECAUSE LOCAL HOUSING SHORTAGES, SURPLUSES, AND CONDITIONS DIFFER THROUGHOUT THE COUNTRY, SUCH BLOCK GRANTS SHOULD BE AVAILABLE FOR REHABILITATION OR NEW CONSTRUCTION AT THE DISCRETION OF THE CITY OR COUNTY. WE SUPPORT THE USE OF THE FUNDS FOR LOANS AND GRANTS IN LOW INCOME AREAS AND URGE THAT THE FUNDS BE AVAILABLE TO ASSIST LOW AND MODERATE INCOME HOUSEHOLDS IN NON-CONCENTRATED AREAS AS WELL. THIS IS PARTICULARLY IMPORTANT IN COUNTIES WHERE THE LOW INCOME POPULATION IS USUALLY DISPERSED.

WE STRONGLY OPPOSE THE ADMINISTRATION'S PROPOSAL THAT NEW HOUSING CONSTRUCTION BE MADE AN ELIGIBLE CDBG ACTIVITY. THE DEMANDS ON THE LIMITED CDBG FUNDS ARE ALREADY GREAT AND THE ADDITION OF A NEW ACTIVITY AS COSTLY AS NEW CONSTRUCTION

WOULD ONLY SERVE TO DRAIN THE COMMUNITY DEVELOPMENT BLOCK GRANT RESOURCES.

WE SUPPORT THE CONCEPT OF HOUSING VOUCHERS OR CERTIFICATES; HOWEVER, WE DO NOT SUPPORT PROGRAM CHANGES WHICH WOULD MAKE THAT HOUSING LESS AFFORDABLE TO LOWER INCOME PERSONS SUCH AS COUNTING FOOD STAMPS AS INCOME OR REQUIRING CERTIFICATE HOLDERS TO PAY UTILITIES.

FINALLY, WE URGE THE CONTINUATION OF THE SECTION 108 LOAN GUARANTEE PROGRAM. THIS HAS BECOME A USEFUL COMMUNITY DEVELOPMENT TOOL. AS AN ILLUSTRATION, LET ME DESCRIBE HOW WE HAVE EFFECTIVELY USED SECTION 108 IN MY COUNTY OF FAIRFAX, VIRGINIA. PERHAPS A NUMBER OF YOU ARE FAMILIAR WITH THE WOODLEY-NIGHTENGALE MOBILE HOME PARK ON ROUTE ONE. THIS CROWDED, DELAPIDATED, AND OUTDATED PARK IS UNDERGOING REDEVELOPMENT AS A RESULT OF OUR CDBG PROGRAM. THE COSTLY PROCESS OF ACQUIRING THE PARK AND ADJACENT LAND, RELOCATING INDIVIDUALS, REBUILDING THE STREETS, SIDEWALKS, AND INFRASTRUCTURE OF THE COMMUNITY, AND REHABILITATING EXISTING MOBILE HOMES, WAS ONLY POSSIBLE THROUGH THE USE OF A $3.5 MILLION 108 LOAN GUARANTEE.

IN CLOSING, MR. CHAIRMAN, I WOULD LIKE TO THANK YOU AND THE MEMBERS OF THE SUBCOMMITTEE FOR THE OPPORTUNITY TO PRESENT TO YOU THE VIEWS OF THE NATIONAL ASSOCIATION OF COUNTIES. WE KNOW THEY WILL BE SERIOUSLY CONSIDERED AND NACo LOOKS FORWARD TO WORKING WITH YOU ON THESE ISSUES IN THE WEEKS AND MONTHS AHEAD.

THANK YOU.

BIOGRAPHY

JAMES SCOTT

JAMES SCOTT IS A COUNTY SUPERVISOR REPRESENTING THE PROVIDENCE DISTRICT OF FAIRFAX COUNTY, VIRGINIA. HE WAS ELECTED TO THE COUNTY BOARD OF SUPERVISORS IN NOVEMBER 1971 AND RE-ELECTED IN 1975 AND 1979. IN ADDITION TO HIS DUTIES AS COUNTY SUPERVISOR, MR. SCOTT HAS SERVED AS CHAIRMAN OF THE NORTHERN VIRGINIA TRANSPORTATION COMMISSION (1980-81), A MEMBER OF THE WATER RESOURCES PLANNING BOARD (1979-80), AND A MEMBER OF THE BOARD OF TRUSTEES FOR THE FAIRFAX HOSPITAL ASSOCIATION (1973-82), AND IS CURRENTLY THE COUNTY REPRESENTATIVE FOR THE WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY.

MR. SCOTT IS A MEMBER OF THE BOARD OF DIRECTORS OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo) AND IS CHAIRMAN OF THE NACo COMMUNITY DEVELOPMENT STEERING COMMITTEE. HE SERVED AS PRESIDENT OF THE VIRGINIA ASSOCIATION OF COUNTIES FROM 1979-80.

MR. SCOTT IS MARRIED WITH ONE DAUGHTER. HE HOLDS A MASTERS DEGREE FROM THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL AND IS CURRENTLY WORKING TOWARD A DOCTORATE IN PUBLIC ADMINISTRATION AT GEORGE MASON UNIVERSITY.

Senator TOWER. Thank you, Mr. Scott. I'd like to turn now to the Honorable Cathy Reynolds, of the City Council of Denver.

KATHY REYNOLDS, CITY COUNCIL MEMBER, DENVER, COLO.; REPRESENTING NATIONAL LEAGUE OF CITIES

Ms. REYNOLDS. Thank you, Mr. Chairman. My name is Cathy Reynolds, I'm a council member from Denver, Colo. I'm here today because I also serve as chairman of the National League of Cities' Committee on Economic Development.

If I may, Mr. Chairman, I would like to submit the National League of Cities' priorities statement for 1983 which was adopted by the board of directors this past week, and also submit for the record a full copy of some testimony. Although I'll spare us the pleasure of reading it today, I'll give you some brief remarks orally.

Senator TOWER. We would incorporate those reports into the record at this point.

[The material referred to follows:]

PRIORITIES FOR AMERICA'S CITIES

ADOPTED BY THE BOARD OF DIRECTORS
OF THE
NATIONAL LEAGUE OF CITIES

MARCH 6, 1983

OVERVIEW

The Nation's cities face difficult problems over the next five years, brought on by the continuing low level of economic activity and cuts in federal and state aid to local governments. The National League of Cities believes that it is now time to shift national policy toward a concerted effort to ensure strong and substantial economic and employment growth and to strengthen the ability of local governments to provide important public services.

To achieve these goals, NLC recommends a four-part program: to restore strong economic growth, to extend and strengthen major urban programs, to begin the task of modernizing the Nation's public infrastructure, and to define certain federal-state-and-local relationships.

President Reagan's FY 1984 budget does not adequately address the needs of the Nation's cities. It accepts slow economic growth and continuing high unemployment, it continues the greatest peacetime arms buildup ever, while forcing devastating additional spending cuts on important social programs; and it provides inadequate help for cities to maintain needed facilities and public-services. NLC believes the President's budget should be substantially revised.

We are particularly concerned over the President's continuing efforts to reduce federal aid for the poor and near-poor. The budget proposes further reductions in such programs as food stamps, aid to families with dependent children, and low income energy assistance. NLC strongly opposes these cuts and urges Congress to reject the President's budget requests.

Despite our concern with the budget, NLC supports current efforts by the Administration and the Congress to develop legislation extending unemployment benefits, creating immediate job opportunities, and providing emergency relief for victims of the recession. We believe such action is an important first step in reducing high unemployment and providing humanitarian aid to thousands of our citizens.

ECONOMIC AND EMPLOYMENT GROWTH

Restoring strong economic and employment growth must be the federal government's highest priority. To achieve this goal, NLC recommends the following:

1. Further Reduce Interest Rates. NLC supports the change in Federal Reserve Board policy to encourage economic expansion and urges that it be maintained. NLC believes the large and growing federal deficits are the major cause of high long term interest rates. NLC urges the Administration, the Congress, and independent agencies of government to adopt a coordinated approach to reduce interest rates during 1983.

2. Reduce the Federal Deficit. To alleviate reasonable fears that high deficits in future years could arrest expected economic recovery, NLC urges Congress and the Administration to reduce projected deficits for FY's 1984-1986 by first, significantly reducing the rate of real growth in defense spending; second, delaying cost-of-living adjustments in all non-needs tested entitlement programs for six months and changing indexing mechanisms in such programs to the lower of the CPI or a wage index; and third, eliminating indexation of tax brackets scheduled to take effect in 1985.

NLC supports eliminating the third year of the tax cut, to take effect on July 1, 1983. We urge the Congress to re-examine other tax reduction provisions, especially those instituted in the 1981 and 1982 tax laws, and to consider eliminating or freezing those provisions.

3. Create Short-Term Jobs Immediately. While a long-term solution to high unemployment must rely on strong and substantial economic growth, we encourage the Administration and the Congress to continue their current efforts to help the unemployed. NLC urges the Congress to enact a short-term jobs program, one that can be initiated quickly, is labor-intensive, includes retraining, and public employment at or above the federal minimum wage. Such jobs should be in addition to the jobs and emergency assistance program now under consideration.

NLC supports a bipartisan social security agreement as an important contribution to restoring public confidence in our basic retirement system. We believe its prohibition on further state and local government withdrawals from the social security system are required at this time to restore the solvency of the social security system.

4. Define a National Industrial Policy. NLC urges the Administration and the Congress to define a national industrial policy that will develop and coordinate tax and spending incentives, improve the international competitiveness of American goods and services, and assist industries and employees affected by international shifts in economic activity.

MAJOR URBAN PROGRAMS

During 1983 Congress must act to reauthorize major urban programs that will otherwise expire. NLC urges timely action by the Congress on these reauthorizations, in order to remove uncertainty in local budgeting for FY 1984 and succeeding fiscal years.

General Revenue Sharing

NLC's first priority for 1983 is reauthorization and reasonable funding for the general revenue sharing program, by all measures the most important federal program of support for local governments. NLC urges a five-year extension of GRS, with a reasonable increase in funding. An increase is justified to help restore the purchasing power of the revenue sharing dollar; enhance the flexibility of cities to respond to cutbacks in other programs during the past several years; and, most important, enable cities to maintain and expand their efforts to deal with the social problems of those hit hardest by the recession.

Community Development Block Grants

NLC urges reauthorization of this key program for five years, with an increase in funding over the President's request of $3.5 billion for CDBG. An increase for CDBG would accommodate the growing number of cities qualifying for entitlement status; the increased demands on CDBG funds resulting from reductions in and terminations of other programs; and the growing need to use CDBG funds for social services. We oppose expansion of CDBG eligible activities when it serves as a means of reducing or eliminating programs in the housing and community development area.

Urban Development Action Grants

We urge the Congress to reauthorize this important program. New UDAG appropriations should be kept at their FY 1983 level ($440 million); the current backlog of funds should be reduced quickly as economic recovery occurs and HUD increases its technical assistance to small cities.

Economic Development Administration

We support the reauthorization of EDA or of similar economic development programs. We oppose the Administration's proposal to transfer funds out of EDA.

Mass Transit

NLC believes that DOT's proposed FY 84 budget is a subversion of the recently-passed surface transportation legislation which was accepted, approved and signed into law by the President and which NLC supported in good faith. Therefore, NLC rejects the proposed transit budget and we strongly urge Congress to restore the full amount of gas tax and general revenue funding agreed to in December, to fund operating assistance at authorized levels, and to continue to allow new starts to be eligible for capital assistance.

Housing

NLC strongly opposes the Administration's continuing efforts to end federally-assisted new and rehabilitated housing for those of low and moderate income, a need the private sector simply cannot meet. We urge the Congress to reject the Administration's general approach to assisted housing and to enact a new construction and rehabilitation program for low- and moderate-income households. In addition, we urge Congress to provide adequate funding levels for public housing operating assistance and modernization in order to preserve the Nation's large stock of public housing.

Employment and Training

NLC supports the President's proposals to extend the federal supplemental compensation program; to implement a dislocated workers' program authorized at a level of $240 million; and, with changes, to authorize a sub-minimum wage for youth.

We support the sub-minimum wage for youth, however, only if the new wage level applies only to youth aged 14 through 18 during the summer months, rather than 14 to 22 as proposed by the President; and if funding for the summer youth program is increased to provide for one million summer jobs, at whatever wage level is agreed to by the Congress.

Natural Gas Pricing

NLC will support natural gas pricing proposals which satisfy the following criteria. Any proposal must:

- restore order to natural gas markets;
- increase comptition in both the production and distribution of natural gas; and
- restrict industry practices which create inequitable market pricing impacts on consumers.

Energy Programs

NLC strongly opposes Administration efforts to eliminate all state and local energy programs, including the Solar and Conservation Bank, low income weatherization funding, the schools and hospitals programs, the Energy Extension Service, and the state energy conservation grant programs.

Environmental Programs

NLC urges the Congress to extend the Nation's two major environmental laws--the Clean Air and Clean Water Acts--but efforts to modify the standards and compliance requirements by acknowledging that economic and natural factor and administrative good sense must be taken into account when applying these compliance requirements. These laws are responsible for substantial improvements in the Nation's physical environment, as well as improved health for the residents of cities. NLC further urges that federal and state authorities responsible for environmental programs to work together in an effort to avoid duplication and unnecessary costs in environmental programs.

NLC requests Congress quickly amend the Clean Air Act by adopting legislation that explicitly provides for more graduated and flexible sanctions. NLC believes EPA should impose funding sanctions and restrictions on new source permits for areas failing to make a good faith effort to comply with the Clean Air Act. However, EPA should be given greater discretion to impose a graduated set of sanctions so that penalties imposed can be tailored to the severity of the violations committed. Sanctions should be imposed on the level of government or agency directly responsible for non-compliance.

NLC urges the Congress to reauthorize the Resources Conservation and Recovery Act with amendments to ensure full cradle-to-grave protection from hazardous materials, and to amend the Hazardous Materials Transportation Act to provide for adequate enforcement and response capacity at the municipal level.

NLC urges the Administration to more effectively implement and enforce the Superfund program and Congress to appropriate adequate funds for research and development activities so that the federal government can reassume a leadership role in protecting public health and safety.

MODERNIZING OUR PUBLIC INFRASTRUCTURE

We urge the Congress and the Administration to develop a comprehensive policy for the modernization of the Nation's infrastructure. Through our task forces on infrastructure and municipal bonds, NLC will work closely with the Congress and the Administration to develop such a policy.

FEDERAL-STATE-LOCAL RELATIONSHIPS

This year Congress will consider three important aspects of federal, state, and local relationships: first, the President's revised "New Federalism" proposal; second, the right of states and localities to regulate the growing cable television industry through their traditional franchising powers; and third, the potential liability of cities under the federal anti-trust laws, brought on by the Supreme Court's Boulder decision.

New Federalism

The President has proposed a New Federalism involving four "block grants": a "state block grant", a "federal-local block grant (CDBG and GRS)", a "transportation block grant" and a "rural housing block grant". NLC opposes these four block grants.

Cable Television

An industry-backed effort to reduce significantly state and local authority over cable services and prohibit the setting and enforcement of reasonable regulatory requirements is being given serious congressional consideration. At stake is city authority to regulate rates, ensure the availability of public, educational, and governmental access programming, consider competing bids from cable companies during the refranchising process, set franchise fees, and own and operate cable systems. NLC strongly opposes this unnecessary federal legislation that would unjustifiably preempt local rights in this area and shift basic accountability from the most immediately involved service areas. The federal government should limit foreign ownership of cable systems only if it can be shown that such ownership threatens the domestic cable industry and does not enhance competition.

Anti-Trust Liability

The Supreme Court's decision in Community Communications Company, Inc. v. City of Boulder (1982) to subject the governmental activities of cities to scrutiny under the anti-trust laws has created widespread uncertainty as to the extent of municipal authority. In order to preserve local authority, NLC urges the Congress to amend the anti-trust laws to exempt cities from liability to the same extent as states under Parker v. Brown and subsequent Court decisions.

Ms. Reynolds. First, community development, is an obvious priority for the National League of Cities. NLC urges reauthorization of the CDBG program for 3 years, with an increase over the administration's request of $3.5 million.

An increase of funding would accommodate the growing number of cities that will qualify for entitlement status and the increased demand on CDBG funds resulting from the reductions in and terminations of other programs.

NLC strongly opposes the administration proposal to add new housing construction as an eligible activity under CDBG, to eliminate the provision that permits cities to make lump sum drawdowns of CDBG allocations for rehabilitation and the termination of the section 108 loan guarantee program.

In addition, we urge the committee to revise the current provisions regarding the 10-percent limitation on the use of public services under CDBG.

We have submitted a detailed proposal regarding these changes to the subcommittee staff.

NLC opposes the administration's proposal to require mandatory administration of the CDBG small cities program by States. We view the continuation of the State role as an experiment whose value must be assessed after a reasonable period of time.

We urge the committee to establish in law effective direction to the State program in order to bring it into conformity with the national objectives established by Congress for the CDBG entitlement program.

I would also like to speak to the New Federalism for just a moment, if I may. Although not included in its fiscal year 1984 budget request, the administration has proposed a new block grant that would combine the entitlement portion of the CDBG program and general revenue sharing into one Federal block grant.

NLC strongly opposes combining CDBG with revenue sharing. In our view, eliminating and preventing slums and blight and preserving viable neighborhoods are, and have been, important areas of national concern and responsibility.

While it is true that cities would gain in flexibility, there's no denying that every CDBG dollar transformed into a GRS dollar, which need not be spent on those activities, would dilute that national concern and responsibility.

This week our board of directors overwhelmingly took the position that these two programs should not be included in the New Federalism proposal.

The administration's budget proposes only a $196 million in fiscal year 1984 for the CDBG program, a decrease of $244 million from the $440 million appropriated in fiscal year 1983.

We urge that this important economic development tool for our cities be reauthorized to at least $440 million in fiscal year 1984. We believe the current backlog of funds should be reduced quickly as economic recovery occurs.

In addition, we urge that HUD increase its technical assistance efforts for small cities, which comprise a substantial portion of the backlog.

We strongly oppose the administration's proposal to shift MSA central cities with populations under 50,000 from the large city UDAG program to the small cities UDAG program.

We believe that these cities, as entitlement cities under the CDBG program, should continue to compete with the large city portion of UDAG.

The HUD fiscal year 1984 budget proposals continues drastic reductions in new funding for section 8 and public housing assistance. Once again, the Administration relies on a housing voucher program as the major vehicle for providing housing assistance to low- and moderate-income households.

NLC strongly opposes the administration's efforts to end federally assisted new and rehabilitated housing for our needy citizens. We urge the committee to reject the administration's general approach to assisted housing and to enact a new construction and rehabilitation program for low- and moderate-income households.

In addition, NLC opposes the administration's proposed housing payment certificates or voucher progam that would substantially reduce the value and the benefits of such certificates to low- and moderate-income households.

RESHAPE RENTAL REHABILITATION GRANT PROGRAM

We commend the efforts of the committee to reshape the administration's rental rehabilitation grant program by increasing the authorization from $150 million to $300 million in 1984, and permitting up to 10 percent of the funds to be made available for innovative housing programs including new construction.

We believe that this approach to providing housing assistance is headed in the right direction in its recognition of the need for a housing production program, the allocation of housing funds by formula, and the pivotal role local governments must play in addressing their local housing problems.

However, it is inadequate in terms of replacing public housing and section 8 new and substantial rehabilitation, as well as the 312 rehabilitation loans and section 8 moderate rehabilitation programs.

Over the last two months the National League of Cities and the U.S. Conference of Mayors and the Council of State Housing Agencies have been exploring the feasibility of a multiple delivery system to address the problems of providing new construction and rehabilitation assistance for low- and moderate-income persons.

Our proposal contains the following major features: Primary roles for local and State governments; separate allocations for metropolitan cities; and small cities through States, HUD, and State housing finance agencies; use of a needs based formula for distributing the funds; maximum flexibility for city governments in using the funds; providing that 75 percent of program funds be spent for housing for low- and moderate-income households; and the availability of a voucher program like the current section 8 existing housing certificates to accompany the program and to provide the necessary ongoing subsidy for tenants.

Such a new program design is based on the continued operation of several existing programs, including the current Farmers Home

Administration programs; section 202 housing for the elderly and handicapped; a modest level of development authority for new public housing units; and the continued availability of tax-exempt mortgage revenue bonds.

As the debate continues on formulating new alternatives to the section 8 construction and substantial rehabilitation programs, we look forward to working with this subcommittee in developing a reasonable solution to providing assistance to our low- and moderate-income households.

In fiscal year 1984 the administration's major public housing initiative is the reshaping of how public housing operating subsidies are calculated.

The new proposal would allocate operating subsidies based on the fair market rent for comparable units in the area. In addition, after a 4-year transition period, the administration proposes to eliminate the existing separate public housing modernization program and combine it with operating subsidies.

The National League of Cities opposes the combining of public housing operating subdsidies and modernizaton funding under the new "fair market rent" configuration.

We believe that improvements can be made in the existing operating subsidies formula, but the distinct purposes and funding for public housing operating subsidies and modernization must continue at reasonable levels in order to protect the Nation's investment in our existing public housing stock.

Mr. Chairman, I appreciate the opportunity to appear before you this morning. Thank you very much.

[The complete statement follows:]

STATEMENT
OF
CATHY REYNOLDS, COUNCIL MEMBER, DENVER, COLORADO
FOR THE
NATIONAL LEAGUE OF CITIES
MARCH 9, 1983

Mr. Chairman and members of the Subcommittee, I am Cathy Reynolds, Council member of Denver, Colorado. I serve as chairman of the Community and Economic Development Policy Committee of the National League of Cities (NLC).

NLC, as you know, represents over 15,000 municipalities through our network of state municipal leagues and nearly 1,000 direct member cities. I am pleased to be here today to express our views on legislation critical to our nation's cities, the reauthorization of community development and housing programs.

If I may, Mr. Chairman, I would like to submit for the record the National League of Cities' Priorities for 1983.

Community Development

Since its creation in 1974, with the consolidation of the various categorical urban development programs, the Community Development Block Grant Program (CDBG), has demonstrated its effectiveness and has become one of the most important federal assistance programs for our local governments. The CDBG program has significantly improved the ability of cities to mobilize resources to deal with the problems of housing, neighborhood conservation and revitalization. The block grant program provides cities with a basic level of predictable, flexible, on-going funding, while being sufficiently targeted to carry out national objectives established by Congress. We believe these are important features which must be retained.

NLC urges reauthorization of the CDBG program for 3 years, with an increase over the administration's request of $3.5 billion for CDBG. An increase in CDBG funding would accommodate the growing number of cities that will qualify for entitlement status; the increased demands on CDBG funds resulting from the termination of the 312 rehabilitation loan program and substantial reductions in such programs as low-income weatherization and EDA; and greater pressure on the use of CDBG funds for social services.

NLC strongly opposes the administration's proposals to add new housing construction as an eligible activity under CDBG, to eliminate the provision that permits cities to make lump sum draw-downs of CDBG allocations for rehabilitation and the termination of the Section 108 loan guarantee program, which permits CDBG entitlement recipients to finance the acquisition and rehabilitation of real property.

We believe that the addition of new housing construction will put undue pressure on the limited CDBG dollars at a time when assisted housing new construction funds have been drastically reduced.

The Section 108 program has proved to be an increasingly important development tool. Last year, according to HUD, a record 52 applications were approved for a total of $179 million in guaranteed loans. These were credited with creating or saving many jobs, leveraging considerable new private investment, and significantly increasing local tax revenues. HUD expects an even greater demand for these resources this year.

In the case of lump-sum drawn loans, we believe that the barring of such draw-downs would punish the vast majority of cities which have not abused this provision, for the sake of the few that have. We urge HUD to take immediate action against those cities which have improperly used this provision.

We also urge the committee to revise the current provisions regarding the 10 percent limitation on the use of social services under CDBG. Under existing law, localities which exceed this limit are permitted to seek waivers from HUD, in order to maintain the higher levels of spending which they had reached prior to the 1981 CDBG amendments.

Our proposed change would permit those localities, which during fiscal years 1981 through 1983, exceeded the 10 percent limitation, to maintain a level of spending in this area at a level equal to but not exceeding the maximum amount or percentage spent on such activities during those fiscal years. This proposal would eliminate the requirement that cities ask HUD to evaluate requests for such waivers, providing those localities greater discretion and flexibility in addressing their social services needs. Other communities that had not requested the waivers during fiscal years 1981, 1982 and 1983 would continue to be subject to the 10 percent limitation on social services.

Small Cities

NLC opposes the administration's proposal to require mandatory administration of CDBG small cities program by states. We did not support the transfer of the small cities program to the states under the 1981 amendments. However, now that the transfer has begun, with many states developing and implementing their programs, repeal of this provision would disrupt these programs for small cities. We view the continuation of the state role as an experiment whose value must be assessed after a reasonable period. We understand HUD has commissioned such a study.

We urge the Committee to establish in law effective direction to the state program including, ensuring that activities under the program principally benefit low and moderate income persons; requiring that funds be distributed by the state on a competitive basis; requiring that states pass through certification requirements in the area of civil rights and other federal standards to local grantees; establishing uniform reporting requirements for states or localities; and providing direction as to the respective federal and state responsibilities for monitoring the use of funds of local grantees. Moreover, states should engage in meaningful consultation with small cities throughout the course of the program. We believe that these provisions will ensure that the CDBG small cities program carries out the national objectives established by Congress for CDBG entitlement program.

New Federalism

Although not included in its fiscal year 1984 budget request, the administration has proposed a new "mega-block grant" that would combine the entitlement portion of the CDBG program and General Revenue Sharing into one federal-local block grant. Each year cities could receive up to 20 percent of their CDBG entitlements in revenue sharing payments, so that in the fifth year a city could receive all of its CDBG funds in "no strings attached" revenue sharing. At the same time, others could opt to continue any or all of the CDBG program as now administered by HUD.

In addition, the state and HUD small cities CDBG programs would be incorporated into an overall state fiscal assistance trust fund, along with 22 other federal agencies' programs.

NLC strongly opposes combining CDBG with revenue sharing. In our view, eliminating and preventing slums and blight and preserving viable neighborhoods are, and have been, important areas of national concern and responsibility. While it is true that cities would gain in flexibility, there is no denying that every CDBG dollar transformed into a GRS dollar, which need not be spent on these activities, would dilute that national concern and responsibility. This week our Board of Directors overwhelmingly took the position that these two programs should not be included in any new federalism proposal.

Urban Development Action Grants

The administration's budget proposes only $196 million in fiscal year 1984 for the CDBG program, a decrease of $244 million from the $440 million appropriated in fiscal year 1983. We urge that this important economic development tool for our cities be reauthorized to at least $440 million in fiscal year 1984. We believe the current backlog of funds should be reduced quickly as economic recovery occurs. In addition, we urge that HUD increase its technical assistance efforts to small cities, which comprise a substantial portion of the backlog.

We strongly oppose the administration's proposal to shift MSA central cities with populations under 50,000 from the large city UDAG program to the small cities UDAG program. We believe that these cities, as entitlement cities under the CDBG program, should continue to compete within the large city portion of UDAG.

Housing Assistance

The HUD FY'1984 budget proposes continued drastic reductions in new funding for Section 8 and public housing assistance. Under the administration's plan, there would only be $515 million in new budget authority for assisted housing in FY 1984. It assumes the recapture of funds through the cancellation of thousands of commitments for new or rehabilitated housing units already approved under the Section 8 and public housing programs. Once again, the administration relies on a housing voucher program as the major vehicle for providing housing assistance to low- and moderate income households.

NLC strongly opposes the administration's efforts to end federally-assisted new and rehabilitated housing for our neediest citizens. NLC believes that the administration's approach would have a devastating impact on the ability of many low-income families to find or retain adequate shelter. We urge the committee to reject the administration's general approach to assisted housing and to enact a new construction and rehabilitation program for low- and moderate-income households.

In addition, NLC opposes the administration's proposed Housing Payment Certificates or voucher program that would reduce the current 15-year subsidy term to 5 years; raise the current cap on rent increases from 10 percent to 20 percent of income; and count the value of food stamps as income. We believe that an existing housing certificate program is a necessary component of any housing assistance program, but not when it substantially reduces the value and benefits of such certificates to low and moderate income households.

We commend the efforts of the committee to reshape the administration's rental rehabilitation grant program, by increasing the authorization from $150 million to $300 million in FY 1984, and permitting up to 10 percent of the funds to be made available for innovative housing programs, including new construction. We believe that this approach to providing housing assistance is headed in the right direction in its recognition of the need for a housing production program, the allocation of housing funds by formula, and the pivotal role local governments must play in addressing their local housing problems. However, it is inadequate in terms of replacing public housing and Section 8 new and substantial rehabilitation, as well as the 312 rehabilitation loan and Section 8 moderate rehabilitation programs.

Over the last few months, the National League of Cities, U. S. Conference of Mayors and the Council of State Housing Agencies have been exploring the feasibility of a multiple delivery system to address the problems of providing new construction and rehabilitation assistance for low and moderate income persons. Our proposal contains the following major features: primary roles for local and state governments; separate allocations for metropolitan cities, and small cities through states, HUD, and state housing finance agencies; use of a needs based formula for distributing the funds; maximum flexibility for city governments in using the funds; providing that 75 percent of program funds be spent for housing for low and moderate income households; and availability of a voucher program like the current Section 8 existing housing certificates to accompany the program to provide the necessary on-going subsidy for tenants.

Such a new program design is based on the continued operation of several existing housing program, including the current Farmers Home Administration programs; Section 202 housing for the elderly and handicapped; a modest level of development authority for new public housing units; and the continued availability of tax-exempt mortgage revenue bonds.

As the debate continues on formulating new alternatives to the Section 8 construction and substantial rehabilitation programs, we look forward to working with this subcommittee in developing a reasonable solution to providing assistance for our low and moderate income households.

Public Housing

In FY 1984 the HUD budget provides for no additional public housing development funds. Instead, the administration's major public housing initiative is the reshaping of how public housing operating subsidies are calculated. Currently, the subsidies are intended to cover the difference between income from tenant rents and the historical costs of operating public housing projects. The new proposal would allocate $1.6 billion for subsidies in FY 1984, based on the "fair market rent" for comparable units in the area. In addition, after a four year transition period, the administration proposes to eliminate the existing separate public housing modernization program and combine it with operating subsidies. The HUD budget proposes $1.4 billion for modernization in FY 1984.

NLC opposes the combining of public housing operating subsidies and modernization funding under a new "fair market rent" configuration. We believe that improvements can be made in the existing operating subsidies, Performance Funding System (PFS), but the distinct pur-oses and funding for public housing operating subsidies and modernization must continue at reasonable levels in order to protect the nation's investment in our existing public housing stock.

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you and present the views of the National League of Cities.

Senator Tower. Thank you very much, Miss Reynolds. We'll next hear from Mr. Juan Montes.

JUAN MONTES, CAMPANA PRO PRESERVACION DEL BARRIO, EL PASO, TEX.: REPRESENTING WORKING GROUP FOR COMMUNITY DEVELOPMENT REFORM, ACCOMPANIED BY PAUL BLOYD

Mr. Montes. My name is Juan Montes for El Paso, Tex. I work with La Campana Pro Preservacion del Barrio (Campaign to Preserve the Community), a grassroots community organization in its ninth year of existence.

I work primarily—centers in the Segundo Barrio, a residential community of approximately 15,000 residents located between downtown El Paso and Ciudad Juarez, Mexico.

La Campana was formed as a response to the mass demolition and forced eviction of thousands of our people. We have lost one half of our population in less than 10 years due to Government actions and inactions.

Senator Tower. Would you yield for a question at that point, Mr. Montes?

Was that influenced primarily by the Chamizan settlement?

Mr. Montes. This is between the bridges and the downtown area.

Ms. Reynolds. So the redirection of the boundary by the Chamizan settlement——

Mr. Montes. It was more to the east, the southeast.

Senator Tower. Thank you.

Mr. Montes. After years of struggling against the annihilation of our barrio by local and Federal programs, we took the initiative of struggling against the annihilation of our barrio by local and Federal programs.

SOUTHSIDE LOW-INCOME DEVELOPMENT CORPORATION

We took the initiative of establishing the South Side Low-Income Development Corporation in order to bring badly needed housing to our community.

In spite of the fact that the horrendous living and housing conditions of the barrio have been documented time and again by both HUD and the city and these housing conditions have been used to legitimize the city of El Paso's applications for CDBG funds, less than 1 million out of 43 million received by the city has been allocated to south side's housing programs.

I'm here today to express our community's concerns about the need for Congress to provide legislative protections against HUD's plans for the CDBG program as expressed in its letter to the committee dated February 25, 1983, its earlier regulation proposals, and the White House plan to dissolve CDBG in the general revenue sharing programs.

All these plans will adversely affect low-income communities.

In summary, our concerns center on: First, HUD's intent to not conduct a review of the local programs that will assure principal benefit to low- and moderate-income people and its unwillingness to make principal benefit a program requirement. Second, HUD's expressed interest in maintaining flexibility for higher-income ceilings. Third, inadequate protections against displacement's effects of revitalization activity; fourth, dilution of the affordability requirements for multifamily housing rehabilitation to be met to satisfy the low/mod benefit requirement.

I'll be referring to these concerns throughout this testimony.

It is also necessary to give a brief overview of the housing conditions and demographic data of El Paso's Segundo Barrio community so you may better understand our reason for these concerns.

The housing stock in Segundo Barrio consists predominantly of tenement structures. The average tenement is a two-story brick edifice containing 20 to 24 dwelling units with 1 outdoor coldwater faucet and 2 outdoor toilets per floor.

The average dwelling unit consists of two rooms with exposed electrical wiring, cracked wooden floors, crumbling walls, broken windows, and rodents.

The 1970 census report documents that of the total 4,514 year-round units in South El Paso, 3,360 or 74 percent lack some or all plumbing facilities.

While the citywide unemployment hovers at 16 percent, the Segundo Barrio unemployment rate is easily threefold, and is exemplified by the hundreds of men on the streets in the early morning hours waiting for an opportunity to work, even at below minimum wage.

La Campana Pro Preservacion del Barrio has used every conceivable strategy to get the city to respond to the conditions of the barrio. Members of our community have participated in public hearings. We have met with community development adminstrators, elected officials, and HUD bureaucrats offering specific recommendations for what is needed in the barrio.

We have submitted administrative complaint after administrative complaint. As a result in 1980 HUD instructed the city to eliminate South El Paso as a neighborhood strategy area.

Rather than instructing the city to develop appropriate programs, HUD bureaucrats stated that the administrative complaint had served to document that the problems in the Segundo Barrio were so severe that the city would be unable to meet the housing and community development needs of the NSA within 6 to 9 years.

Consequently, in El Paso community development funds are no longer targeted to the neediest areas, and HUD condoned it.

EL PASO'S MULTIFAMILY REHAB PROGRAM

El Paso's multifamily rehab program is a prime example of a harmful rather than a beneficial program. In this rehab program's short existence of 1 year, it has permanently displaced over 120 low-income families. This past September, 48 families were simultaneously evicted from four tenements with no relocation assistance whatsoever.

The worst aspect of this program is the insensitive, inhumane manner in which it has been implemented. Tenants are not told of the impending rehab until the day they receive a 1-month notice to vacate. Not being able to find housing, partly because of the lack of any type of relocation assistance, and partly because of a vacancy rate of less than 2 percent, tenants find themselves in an indefensible legal position. Tenement owners and realty agents then intimidate and harass tenants until they are literally forced to move, and usually into even worse living conditions.

Once four or five units are empty, whole construction crews invade the tenement building and commence to demolish the units on top of the remaining tenants. The noise, pollution, and increased traffic creates an uninhabitable atmosphere, putting tremendous strain on family life. The few families that remain, unable to find housing, are forced be bear the dangers of living in a construction site. CD rehab staff work with realtors to create such an atmosphere, and do nothing to mitigate the adverse effects that they themselves have created. To date, CD staff or relocation employees have not contacted or informed tenants evicted in September of any replacement housing whatsoever. In short, relocation assistance in the city of El Paso does not exist in a meaningful way, and will not exist until HUD obligates the city to take action.

HUD's typical response is that they could not intervene because it is a local jurisdictional matter, and HUD cannot meddle in the city's affairs. HUD washes its hands of its responsibilities of enforcing relocation assistance and antidisplacement strategies to the detriment of low-income tenants.

The fact that third party indirect displacement occurs rules out the possibility of tenants' being protected under the Uniform Relocation Act. The only benefits received by tenants are based on an outdated Federal Highway Administration schedule, and even these benefits are not released if tenants owe back rent or deposits.

A third issue, and most important one, is who will live in the rehabbed units. Although city rehab staff give lip service to tenants' rights of first refusal, this is a sham, since, first, rents are increased fourfold, making them unaffordable; and second, the rehabbed units are so small that families with children are not even allowed to reapply, much less move back in.

Our organization has struggled consistently for new construction and rehabilitation of housing in our community. Ironically, we convinced the city to deal with multifamily rehab since their original rehab program targeted for Segundo Barrio dealt only with single-family, owner-occupied homes in an area where 91 percent of the residents are renters.

REHAB PROGRAM IS SERIOUSLY DEFICIENT

The design of the multifamily rehab program is seriously deficient in that there are no safeguards which insure that low-income people will be the beneficiaries, not just the displacees of this program. Specifically, safeguards are necessary to assure the affordability of the units after rehab for low-income renters, and that families with children not be discriminated against. The irony of it all is that we are forced to live in substandard units for decades. Then, when our homes are made adequate, they are for someone else.

As you can see, our concerns about HUD review of program benefit, of income ceilings, of HUD's lack of adequate protections against displacement and its unwillingness to define "affordability" in rehab requirements that need to be met to satisfy low- and moderate-benefit requirements are based on our community's continuing experience with this program.

In conclusion, it should be noted that we have described only one of the many CDBG programs in El Paso that harm instead of benefit low-income people. The essence of this testimony is that CDBG funds do not get to the people they are intended to, yet huge profits are made by slumlords, contractors, and bankers. From our perspective in the Barrio, we see that HUD does not know what is going on, and when it does, it is impotent to act because of weak, unenforceable regulations.

To close in a positive vein, we propose that Congress counter HUD's expressed intentions to weaken the targeting of the CDBG program and that it support the following:

Prohibit any type of displacement of low-income residents caused by federally funded projects which lack provision for adequate replacement housing and the opportunity to remain in the neighborhood.

Adopt an adequately funded entitlement and income-based housing assistance program to enable low-income people to obtain decent housing at costs they can afford.

Expand production and preservation programs to meet those low-income housing needs which cannot and will not be met by an income support policy alone.

Reaffirmation of the Federal Government's role in guaranteeing fair access to housing of all citizens, including strengthening of the Federal fair housing law and its enforcement.

Lastly and most importantly to us, a strong role for community-based, nonprofit organizations in the implementation of housing programs, along with the availability of Federal assistance to meet a broad range of housing needs at the neighborhood and community level.

Now, I would like to pass to Mr. Paul Bloyd.

Mr Bloyd. Mr. Chairman, I believe it's significant that prior to Mr. Montes' testimony none of the city or county witnesses made any comment on HUD's proposal that would negatively affect the act's primary objective of benefiting low- and moderate-income people. Problems with the 1982 community development block grant program affecting benefits to low- and moderate-income residents are described in the working group's most recent report, the title of which is "The CDBG Program in 1982: A Move Toward Revenue-Sharing," which I request be made part of the record.

Senator Tower. It will be made part of the record.

[Material referred to follows:]

LA CAMPAÑA PRO PRESERVACIÓN DEL BARRIO
POST OFFICE BOX 1489
EL PASO, TEXAS

STATEMENT OF JUAN MONTES BEFORE THE SENATE SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT

MARCH 9, 1983

MY NAME IS JUAN MONTES FROM EL PASO, TEXAS. I WORK WITH LA CAMPAÑA PRO PRESERVACIÓN DEL BARRIO (CAMPAIGN TO PRESERVE THE COMMUNITY), A GRASSROOTS COMMUNITY ORGANIZATION IN ITS 9TH YEAR OF EXISTENCE. OUR WORK PRIMARILY CENTERS IN THE SEGUNDO BARRIO, A RESIDENTIAL COMMUNITY OF APPROXIMATELY 15,000 RESIDENTS LOCATED BETWEEN DOWNTOWN EL PASO AND CIUDAD JUAREX, MEXICO. LA CAMPAÑA WAS FORMED AS A RESPONSE TO THE MASS DEMOLITION AND FORCED EVICTIONS OF THOUSANDS OF OUR PEOPLE; WE HAVE LOST ONE-HALF OF OUR POPULATION IN LESS THAN TEN YEARS DUE TO GOVERNMENTAL ACTIONS AND INACTION. AFTER YEARS OF STRUGGLING AGAINST THE ANNIHILATION OF OUR BARRIO BY LOCAL AND FEDERAL PROGRAMS, WE TOOK THE POSITIVE INITIATIVE OF ESTABLISHING THE SOUTHSIDE LOW INCOME HOUSING DEVELOPMENT CORPORATION (SLIHDC) IN ORDER TO BRING BADLY NEEDED HOUSING TO OUR COMMUNITY. IN SPITE OF THE FACT THAT THE HORRENDOUS LIVING AND HOUSING CONDITIONS OF THE BARRIO HAVE BEEN DOCUMENTED TIME AND AGAIN BY BOTH HUD AND THE CITY AND THESE HOUSING CONDITIONS HAVE BEEN USED TO LEGITIMIZE THE CITY OF EL PASO'S APPLICATIONS FOR CDBG FUNDS, LESS THAN $1 MILLION OUT OF OVER $43 MILLION RECEIVED BY THE CITY HAS BEEN ALLOCATED TO SLIHDC'S HOUSING PROGRAM.

I AM HERE TODAY TO EXPRESS OUR COMMUNITY'S CONCERN ABOUT THE NEED FOR CONGRESS TO PROVIDE LEGISLATIVE PROTECTIONS AGAINST HUD'S PLANS FOR THE COMMUNITY DEVELOPMENT BLOCK GRANT AS EXPRESSED IN ITS LETTER TO THE COMMITTEES DATED FEBRUARY 25, 1983, ITS EARLIER REGULATION PROPOSALS, AND THE WHITE HOUSE PLAN TO DISSOLVE CDBG INTO THE GENERAL REVENUE SHARING PROGRAM. ALL THESE PLANS WILL ADVERSELY AFFECT LOW-INCOME COMMUNITIES. IN SUMMARY, OUR CONCERNS CENTER ON:

(1) HUD'S INTENT TO NOT CONDUCT A REVIEW OF THE LOCAL PROGRAMS THAT WILL ASSURE PRINCIPAL BENEFIT TO LOW- AND MODERATE-INCOME PEOPLE AND ITS UNWILLINGNESS TO MAKE PRINCIPAL BENEFIT A PROGRAM REQUIREMENT.

(2) HUD'S EXPRESSED INTEREST IN MAINTAINING FLEXIBILITY FOR HIGHER INCOME CEILINGS.

(3) INADEQUATE PROTECTIONS AGAINST DISPLACEMENT EFFECTS OF REVITALIZATION ACTIVITY.

(4) DILUTION OF THE AFFORDABILITY REQUIREMENTS FOR MULTI-FAMILY HOUSING REHABILITATION TO BE MET TO SATISFY THE LOW/MOD BENEFIT REQUIREMENT.

I WILL BE REFERRING TO THESE CONCERNS THROUGHOUT THIS TESTIMONY. IT IS ALSO NECESSARY TO GIVE A BRIEF OVERVIEW OF THE HOUSING CONDITIONS AND DEMOGRAPHIC DATA OF EL PASO'S SEGUNDO BARRIO COMMUNITY SO THAT YOU MAY BETTER UNDERSTAND OUR REASONS FOR THESE CONCERNS. THE HOUSING STOCK IN SEGUNDO

Barrio consists predominantly of tenement structures. The average tenement is a two-story brick edifice containing 20-24 dwelling units with one outdoor cold water faucet and two outdoor toilets per floor. The average dwelling unit consists of two rooms with exposed electrical wiring, cracked wooden floors, crumbling walls, broken windows, and rodents. The 1970 Census Report documents that of the total 4,514 year-round units in South El Paso, 3,360 (74%) lack some or all plumbing facilities. While the citywide unemployment rate hovers at 16%, the Segundo Barrio unemployment rate is easily threefold and is exemplified by the hundreds of men on the streets in the early morning hours waiting for an opportunity to work even at below-minimum wage.

La Campaña Pro Preservación del Barrio has used every conceivable strategy to get the City to respond to the conditions of the Barrio. Members of our community have participated in public hearings, we have met with Community Development administrators, elected officials, and HUD bureaucrats, offering specific recommendations for what is needed in the Barrio. We have submitted administrative complaint after administrative complaint. As a result, in 1980 HUD instructed the City to eliminate South El Paso as a Neighborhood Strategy Area. Rather than instructing the City to develop appropriate programs, HUD bureaucrats stated that the administrative complaint had served to document that the problems in the Segundo Barrio were so severe that the City would be unable to meet the housing and community development needs of the NSA within 6-9 years. Consequently, in El Paso, community development funds are no longer targeted to the neediest areas and HUD condoned it.

El Paso's Multifamily Rehab program is a prime example of a harmful rather than beneficial program. In this rehab program's short existence of 1 year, it has permanently displaced over 120 families. This past September, 48 families were simultaneously evicted from 4 tenements with minimal relocation assistance. The worst aspect of this program is the insensitive, inhumane manner in which it is being implemented. Tenants are not told of the impending rehab until the day they receive a one-month Notice of Vacate. Not being able to find housing, partly because of the lack of any type of relocation assistance and partly because of a vacancy rate of less than 2%, tenants find themselves in an indefensible legal position. Tenement owners and realtor agents then intimidate and harass tenants, until they are literally forced to move -- and usually into even worse living conditions. Once four or five units are empty, whole construction crews invade the tenement building and commence to demolish the units on top of the remaining tenants. The noise, pollution, and increased traffic creates an unihabitable atmosphere putting tremendous strain on family life. The few families that remain, unable to find housing, are forced to bear the dangers of living in a construction site. CD rehab staff work with realtors to create such an atmosphere and do nothing to mitigate the adverse effects that they themselves have created. To date, CD staff or relocation employees have not contacted or informed tenants evicted in September of any replacement housing whatsoever. In short, relocation assistance in the City of El Paso does not exist in a meaningful way, and will not exist until HUD obligates the City to take action. HUD's typical response was that they could not intervene because it was a "local jurisdictional matter" and HUD cannot meddle in the City's affairs. HUD washes its hands of its responsibilities of enforcing relocation assistance and anti-displacement

STRATEGIES TO THE DETRIMENT OF THE LOW-INCOME TENANT. THE FACT THAT THIRD PARTY "INDIRECT" DISPLACEMENT OCCURS, RULES OUT THE POSSIBILITY OF TENANTS BEING PROTECTED UNDER THE UNIFORM RELOCATION ACT. THE ONLY BENEFITS RECEIVED BY TENANTS ARE BASED ON AN OUTDATED FEDERAL HIGHWAY ADMINISTRATION SCHEDULE AND EVEN THESE BENEFITS ARE NOT RELEASED IF TENANTS OWE BACK RENT OR DEPOSITS. A THIRD ISSUE AND MOST IMPORTANT ONE IS WHO WILL LIVE IN THE REHABBED UNITS. ALTHOUGH CITY REHAB STAFF GIVE LIP SERVICE TO TENANTS' RIGHT OF FIRST REFUSAL, THIS IS A SHAM, SINCE (1) RENTS ARE INCREASED FOUR-FOLD, MAKING THEM UNAFFORDABLE AND (2) THE REHABBED UNITS ARE SO SMALL THAT FAMILIES WITH CHILDREN ARE NOT EVEN ALLOWED TO REAPPLY MUCH LESS MOVE BACK IN.

OUR ORGANIZATION HAS STRUGGLED CONSISTENTLY FOR NEW CONSTRUCTION AND REHABILITATION OF HOUSING IN OUR COMMUNTIY. IRONICALLY, WE CONVINCED THE CITY TO DEAL WITH MULTI-FAMILY REHAB SINCE THEIR ORIGINAL REHAB PROGRAM TARGETED FOR SEGUNDO BARRIO DEALT ONLY WITH SINGLE FAMILY, OWNER-OCCUPIED HOMES IN AN AREA WHERE 91% OF THE RESIDENTS ARE RENTERS. THE DESIGN OF THE MULTI-FAMILY REHAB PROGRAM IS SERIOUSLY DEFICIENT IN THAT THERE ARE NO SAFEGUARDS WHICH ENSURE THAT LOW-INCOME PEOPLE WILL BE THE BENEFICIARIES, NOT JUST THE DISPLACEES OF THIS PROGRAM. SPECIFICALLY, SAFEGUARDS ARE NECESSARY TO ENSURE THE AFFORDABILITY OF THE UNITS AFTER REHAB FOR LOW-INCOME RENTERS AND THAT FAMILIES WITH CHILDREN NOT BE DISCRIMINATED AGAINST. THE IRONY OF IT ALL IS THAT WE ARE FORCED TO LIVE IN SUBSTANDARD UNITS FOR DECADES. THEN WHEN OUR HOMES ARE MADE ADEQUATE, THEY ARE FOR SOMEONE ELSE.

AS YOU CAN SEE, OUR CONCERNS ABOUT HUD REVIEW OF PROGRAM BENEFIT, OF INCOME CEILINGS, OF HUD'S LACK OF ADEQUATE PROTECTIONS AGAINST DISPLACEMENT AND ITS UNWILLINGNESS TO DEFINE AFFORDABILITY IN REHAB REQUIREMENTS THAT NEED TO BE MET TO SATISFY LOW/MODERATE BENEFIT REQUIREMENTS, ARE BASED ON OUR COMMUNITY'S CONTINUING EXPERIENCE WITH THIS PROGRAM.

IN CONCLUSION, IT SHOULD BE NOTED THAT WE HAVE DESCRIBED ONLY ONE OF THE MANY CDBG PROGRAMS IN EL PASO THAT HARM INSTEAD OF BENEFIT LOW-INCOME PEOPLE. THE ESSENCE OF THIS TESTIMONY IS THAT CDBG FUNDS DO NOT GET TO THE PEOPLE THEY ARE INTENDED FOR, YET HUGE PROFITS ARE MADE BY SLUMLORDS OR CONTRACTORS. FROM OUR PERSPECTIVE IN THE BARRIO, WE SEE THAT HUD DOES NOT KNOW WHAT IS GOING ON AND WHEN IT DOES, IT IS IMPOTENT TO ACT BECAUSE OF WEAK, UNENFORCEABLE REGULATIONS.

TO CLOSE IN A POSITIVE VEIN, WE PROPOSE THAT CONGRESS COUNTER HUD'S EXPRESSED INTENTIONS TO WEAKEN THE TARGETING OF THE CDBG PROGRAM AND THAT IT SUPPORT THE FOLLOWING:

- PROHIBIT ANY TYPE OF DISPLACEMENT OF LOW-INCOME RESIDENTS CAUSED BY FEDERALLY FUNDED PROJECTS WHICH LACK PROVISION FOR ADEQUATE REPLACEMENT HOUSING AND THE OPPORTUNITY TO REMAIN IN THE NEIGHBORHOOD.
- ADOPT AN ADEQUATELY FUNDED ENTITLEMENT AND INCOME-BASED HOUSING ASSISTANCE PROGRAM TO ENABLE LOW-INCOME PEOPLE TO OBTAIN DECENT HOUSING AT COSTS THEY CAN AFFORD.
- EXPAND PRODUCTION AND PRESERVATION PROGRAMS TO MEET THOSE LOW-INCOME HOUSING NEEDS WHICH CANNOT AND WILL NOT BE MET BY AN INCOME-SUPPORT POLICY ALONE.

- REAFFIRMATION OF THE FEDERAL GOVERNMENT'S ROLE IN GURANTEEING FAIR ACCESS TO HOUSING BY ALL CITIZENS, INCLUDING STRENGTHENING OF THE FEDERAL FAIR HOUSING LAW AND ITS ENFORCEMENT.

The Working Group
for Community Development Reform

March 9, 1983

Addendum to Statement of Juan Montes

By Paul Bloyd, Project Director

Working Group for Community Development Reform

Problems with the 1982 CDBG program affecting benefit to low- and moderate-income residents are described in the Working Group's most recent report, The CDBG Program in 1982: A Move Toward Revenue Sharing, which I request to be made part of the record.

Fifteen local monitoring groups including El Paso's Campaña Pro Preservación del Barrio found that the 1982 program moved measurably toward a revenue sharing orientation in which public works expenditures were expanded without regard to location or beneficaries, economic development project funding increased without targeting of jobs or training for area residents, and the use of the newly required Statements of Objectives undercut the principal benefit objective of the law.

The report also finds during this period that HUD's demonstration rental rehab program contain features which encourage displacement, and that HUD was slow to carry out its grantee performance and monitoring obligations.

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In documentation of these trends, I cite three statistics from the report:

(1) Out of a total of 117 local objectives analyzed by monitor groups, only 39 -- exactly one third -- demonstrated a clear reference to low- and moderate-income needs. This finding is expected in the light of HUD's repeated interpretation that the benefit requirement takes no precedence over other purposes of the program.

(2) Programs meeting priority needs of lower income residents were reduced or eliminated in 5 out of 15 jurisdictions, by an average of 24% reductions from their previous budgets. This reduction is approximately twice the average overall cut faced by jurisdictions in 1982.

(3) The fifteen jurisdictions spent 21% of their funds on economic development projects, yet in most instances the project statements demonstrated no sign of a comprehensive development strategy or of commitments for jobs or training to area residents. In the light of the intense interest by Congress at this time in job creation programs, with CDBG slated as a major vehicle for these programs, it is especially important that serious legislative and administrative oversight be focused on the program if it is to reach the structurally unemployed.

We believe that the move of CDBG toward revenue sharing this year has been demonstrated sufficiently and that it must be identified as a dangerous and wasteful trend, as much so as the formal proposal of the

Administration to merge CDBG and GRS. With so many federally funded programs being cut or eliminated, CDBG is one of the few remaining resources for meeting housing and community needs of lower income neighborhood residents. Its dilution into a de facto revenue sharing program represents a further loss to these residents.

Problems of HUD's proposed entitlement regulations.

The first and most urgent action needed for Congress to turn the revenue-sharing trend of CDBG around is for this Committee to disapprove of HUD's plans for entitlement regulations in the forms presented thus far. We further urge that serious attention be given to legislative corrections that will prevent the re-emergence of such regulations in the future. The proposed regulations would:

(1) effectively kill the benefit requirement;

(2) open up housing rehabilitation for upper-income residents;

(3) reduce the effectiveness of the anti-displacement protections in the current regulations;

(4) make it less likely that economic development projects would provide jobs for those needing them most; and

(5) permit special assessment to be levied against lower income persons when street and sidewalk work is financed with CDBG funds.

Restoring the local/national balance to CDBG.

In approximately twelve communities, local ordinances or resolutions have been passed which provide continuing protections for citizen participation and targeting of the program. While these actions have proven valuable in those communities, the remaining 2,000-plus jurisdictions and State-operated programs have no such local protections. CDBG is of great potential value to low- and moderate-income communities because of its flexible, decentralized nature, which permits local negotiations about the design and program choices leading to CD-funded projects. But, as Juan Montes has demonstrated in his statement about the experience in El Paso, a federal role in setting out the ground rules for such local negotiating is a critical factor that is required if such residents are to maintain some hope of seeing the actual benefits of the program. When those ground rules are clear and are seriously and consistently enforced, the decentralizing of program planning, implementation, and evaluation does work. The Working Group's newsletter, the CD Citizen, regularly cites dozens of such positive experiences with the program, but most of them are premised on a local belief that the Act is intended primarily to benefit lower income residents.

Proposed amendments to the Act.

The amendments we propose come out of the community monitoring experience in more than a hundred jurisdictions throughout the country. They are intended to reaffirm the local/national balance to this decentralized program and the role of the federal government in setting ground rules out of which an effective local program may develop. Such a program must be true to the primary objective of the Act and must foster local accountability.

These amendments address the specific problems and confusion generated by HUD's proposed entitlement regulations. In several cases, they reflect language already incorporated in the current regulations, which have been in force since 1978.

They cover the following topics:

(1) Clarification of the principal benefit objective.

-- addition to "primary objective" language;

--definition of low/moderate income;

--requirement of attention to low- income needs;

--local recordkeeping for calculation of benefit;

--affordability to, and occupancy by, lower income residents in rehabbed housing units;

--jobs requirements for economic development projects;

--neighborhood commercial facilities requirements;

--job commitments and job creation uses;

--Grantee Performance Report information;

--loan guarantee programs as part of HUD review;

--HUD review obligations and procedures, and clarification of primary objective.

(2) Protections against displacement (certifications.)

(3) Housing Assistance Plan (HAP) clarifications.

- --inclusion of racial categories in required information;
- --occupancy by lower income residents of rehabbed units, attention to substandard units, and priority for vacant units;
- --neighborhood relocation provision;
- --statement of local actions to implement goals.

(4) Prohibition against special assessments.

(5) Required information.

- --identification of projects listed in statements of activities;
- --publication requirements;
- --amendment process where program change exceeds 10% of budget.

(6) Public access to records.

(7) Complaint processes — local, federal.

(8) Enforcement of related statutes.

(9) Urban Development Action Grants (UDAG)

- --opportunities for neighborhood projects and for housing projects and for housing projects.
- --reduced leveraging requirements.

The experience of the past year, especially since the introduction of HUD's proposed regulations in October, makes these amendments necessary as a means of making very clear what is the intent and purpose of Congress in seeing to it that CDBG shall primarily benefit low- and moderate-income persons. We believe that each of these amendments is a necessary element of such clarity. Further, they provide the basis on which local citizens can monitor their local program and thus provide accountability close at hand. Such accountability will make the monitoring responsibility of HUD easier and more effective as well.

We urge this Committee to giver serious consideration to these amendments and to the supporting documents and experience from which they come. Thank you for this opportunity to appear before the Committee.

The Working Group
for Community Development Reform

Proposed Amendments to Housing and Community Development Act of 1974, Title I.

(1) CLARIFICATION OF THE PRINCIPAL BENEFIT OBJECTIVE

ADDITION TO "PRIMARY OBJECTIVE" LANGUAGE

Section 101(c) After the first sentence, insert the following:

"The achievement of the objective shall require that no less than the majority of each grantee's (or sub-grantee in the case of State-operated small cities grants) total project expenditures shall directly benefit persons of low and moderate income."

DEFINITION OF LOW- INCOME.

Section 102(ak). (Definitions) Between 102(a)(8) and (9), insert the following:

"The term "low and moderate income", shall mean income that is at or below 50% and 80%, respectively, of the median income of the grantee jurisdiction or the SMSA, whatever is lower, or in the case of state-operated small cities programs, the state nonmetropolitan median income."

REQUIREMENT OF ATTENTION TO LOW-INCOME NEEDS.

Section 104 (Statement of Activities and Review). Add to Sec. 104(a)(1), as follows:

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"The housing and community development needs of low-income people (at or below 50% of median income) shall be substantially and directly addressed in relation to the severity of their need through the design, location and funding of activities funded under this title."

LOCAL RECORD-KEEPING FOR CALCULATION OF BENEFIT

Section 104(b) (Statement of Activities and Review; Grantee Certifications). Additional sub-numbers after 104(b)(3) as follows:

"(4) Jurisdiction files (subjurisdiction in the case of State-operated small cities program) provide calculations which indicate, for each project, the proportion of direct benefit to low- and moderate-income residents, the proportion attributed to prevention or elimination of slums and blight, and the proportion given to meeting of urgent needs." For projects which claim direct benefit to low- and moderate-income persons, there is available in local files such records as may be necessary to demonstrate such benefit, i.e., income requirements for participation or de facto benefit by low- and moderate-income residents in areas where such projects operate."

AFFORDABILITY AND OCCUPANCY OF HOUSING UNITS

"104(b)(5). The majority of housing units rehabilitated or constructed in whole or in part with CD funds will be affordable to, and occupied by, low- and moderate-income residents. Affordability shall mean rents which constitute no more than 25% of income.

JOB REQUIREMENT FOR ECONOMIC DEVELOPMENT

"104(b)(6). Economic development activities claimed as benefiting low- and moderate-income residents will generate a majority of jobs and training targeted for these residents, and will provide contracts for minority contractors in proportion to the percentage of minorities in the areas served."

NEIGHBORHOOD COMMERCIAL FACILITIES REQUIREMENTS

"104(b)(7). Activities which are designed to attract or retain neighborhood commercial facilities which provide essential services, and which are identified as benefiting low- and moderate-income persons, will be located in low/moderate income neighborhoods and will be designed for use by low- and moderate-income residents.

CRITERIA FOR SLUMS AND BLIGHT AND URGENT NEED

"104(b)(8). Activities which aid in the prevention or elimination of slum and blight will be restricted to areas which qualify as slums and blight under state or local law.

"104(b)(9). Activities designed to meet other community needs having a particular urgency are limited to those needs arising out of an immediate threat which originated no longer than 90 days preceding the implementation of the proposed activities."

JOBS COMMITMENTS AND JOB CREATION USES

"104(b)(10). For all positions funded in whole or in part by grants under this title, the grantee (or subgrantee in the case of State-operated small cities program) has established written policies and operating practices to assure that these jobs are held by low- and moderate-income residents to the maximum extent feasible. In each case where low- and moderate-income residents do not hold such positions, a written justification shall be on file and a plan in place for increasing the number of such residents in such positions.

Where funds under this title are provided for the express purpose of creating jobs, projects supported by such funds shall be implemented within 90 days of receipt of funds. No more than 20% of the funds so earmarked may be expended for purposes other than direct job payrolls and direct training expenses. Jobs and training provided for this purpose shall be targeted exclusively for low- and moderate-income residents who have been unemployed for at least half of the year prior to their application for such jobs or training, with priority to be given to longer-term unemployed residents.

GRANTEES PERFORMANCE REPORT INFORMATION.

Section 104(d) (Statement of Activities and Review). Insert the following new sentence after the first sentence:

"In order to assure a uniform review of the various programs conducted by different States and local jurisdictions in accordance with this title, and to assure compliance with the primary objective of the Act, the Secretary shall provide that performance reports and assessments submitted by each State or local jurisdiction shall be made on a standard form that is prescribed by the Secretary and that such reports shall include, but not be limited to, information on projected and actual benefit to low- and moderate-income and minority persons from program activities on a project-by-project basis. Funds allocated to an activity shall be considered to benefit low- and moderate-income persons in the same proportion as the percentage of low- and moderate-income persons directly benefiting from the activity.

LOAN GUARANTEE PROGRAMS AS PART OF HUD REVIEW

Add an additional new sentence to the section added above in

104(d)(1), as follows:

"The HUD review activity shall determine whether the progam as a whole, including activities funded through the use of loan guarantees, principally benefits low- and moderate-income residents."

HUD REVIEW OBLIGATIONS AND CLARIFICATION OF "PRIMARY OBJECTIVE"

Section 104(d)(1). Change "primary objectives" to "primary objective."

At the end of the 104(d)(1), after "manner" and before "and", add the following:

"In these reviews, HUD shall primarily establish whether or not, and to what extent, the program under review has principally benefited low- and moderate-income persons. Reviews shall include, but not be limited to, the following: examination and comparison of Statements of Objectives and Proposed Activities, Grantee Performance Reports, Amendments, local file documentation, (including documentation files, on-site project visits, and meetings and correspondence with program operators and with affected residents and representative community groups.)

PROTECTIONS AGAINST DISPLACEMENT

(2) PROHIBITION AGAINST INVOLUNTARY DISPLACEMENT. (Certification)

Section 104(b), insert the following in place of (4)as (b)(ii) "No person shall be displaced involuntarily, directly or indirectly, from his/her neighborhood nor shall he/she be relocated to less-than-standard housing as a result of activities funded in whole or in part by this title."

REQUIREMENT FOR ANTI-DISPLACEMENT STRATEGY. (Certification)

Following the new 104(b)(4), above, add (5) as follows: "An anti-displacement strategy statement has been prepared or updated and such strategy identifies (1) prevention and anticipatory actions to be taken in connection with any projected activity identified as having a potential for displacement of low- or moderate-income residents and (2) provisions for voluntary relocation under 104(b)(4) above."

(Continue with "the grantee will comply with the other provisions of this title and with other applicable laws", which now becomes (6).

(3) HOUSING ASSISTANCE PLAN

INFORMATION BY RACE.

Section 104(c)(1)(A), after "accurately surveys the condition of the housing stock in the community and assesses the housing assistance needs of lower income persons", add "by race", and continue.

SUBSTANDARD UNITS, VACANT UNITS

Section 104(c) (1)(B)(iii), change "in the case of subsidized rehabilitation, adequate provisions to assure that a preponderance of persons assisted should (emphasis added) be of low and moderate income" to "will be. . .", and add new sentencesas follows before (C):

"Units identified for rehabilitation shall be restricted to those that are substandard. Vacant units shall be assigned highest priority.

NEIGHBORHOOD RELOCATION PROVISION

Section 104(c)(1)(C)(i), delete "of a reasonable opportunity", to read: "...including provision -- (deleted) - for tenants displaced as a result of such activities to relocate in their immediate neighborhood..."

STATEMENT OF LOCAL ACTIONS TO IMPLEMENT GOALS.

Section 104(c)(1), Add new section Section 104(c)(1), as follows:

"The housing assistance plan shall include a narrative statement of local actions proposed to be taken in order to implement the stated goals.

These actions may include, but not be limited to: acquisition of land, formation of a public housing agency, rezoning, efforts to seek state, local or private subsidies."

(4) PROHIBITION AGAINST SPECIAL ASSESSMENTS

Section 105(a)(2) (Eligible Activities). Add the following sentence: "Special assessments to recapture some or all of the costs of projects funded in whole or in part under this title shall not be imposed on low- and moderate-income persons."

(5) REQUIRED INFORMATION

STATEMENT OF OBJECTIVES AND PROPOSED USES OF FUNDS.

Section 104(a)(1) (Statements of Activities and Review). After (1), insert the following, which becomes (2):

"Statements of Objectives and projected uses of funds shall identify, for each grantee project, the name of said project, its geographic area, the amount of projected funds assigned to it, and whether it is intended to principally benefit low- and moderate- income persons, prevent or eliminate slums and blight, or meet urgent needs.

Continue with "In order to permit public examination...." which becomes (3).

PUBLICATION REQUIREMENTS.

After (3)(C) above (formerly (2)), add (3)(D), as follows: "Publish the information, statements, and notice of hearings at least 30 days prior to proposed meetings or decisions on the proposals. Such publication shall appear in the non-legal section of at least one major daily newspaper and in at least one journal in each affected neighborhood. Such published information shall be prominently displayed and shall appear in English and in language(s) known to be in use by affected residents. The information shall specify times, places, dates, and activities to take place at such meetings or hearings."

AMENDMENT PROCESS

Add new section 104(a)(3)(E) formerly 104(a)(2)), as follows: "Publish an amended Statement and Projected Uses of funds, hold one or more hearings and submit the revised statement to HUD, when activities planned after the final Statement has been submitted to HUD differ substantially from those reflected in the final Statement, either through elimination of one of the activities or through budget adjustments exceeding 10% of the total for any project. Such activities may be carried out only after such publication, hearing and submittal. This publication, hearing, and submittal, will take place no later than 30 days prior to the planned implementation of such activities."

(6) PUBLIC ACCESS TO RECORDS.

Add new section 104(a)(3)(F) (formerly 104(a)(2)), as follows: "provide access and information on the program to the public as follows:

(i) copies of statements of objectives and projected uses of funds, both proposed and final; amendments; grantee performance reports; and housing assistance plans; shall be available to the public at no cost, upon request, and be available for review;

(ii) the grantee performance report shall be presented at a public hearing prior to its submission to HUD and shall be available to the public hearing at least 15 days prior to such hearing.

(iii) support documents pertaining to the planning, implementation and evaluation of project activities, including benefit calculations and documentation, shall be available for review and for duplication at no more than the cost of xerox copies.

(7) COMPLAINT PROCESS

104 (a)(3). Written request for information, and written complaints, shall be responded to in writing by the grantee (or subgrantee in the case of State-operated small cities programs) within 14 days of receipt of the request or complaint."

After Section 104(g) (Statement of Activities and Review), add new section 104 as follows:

"The Secretary shall provide for Area Office review and response to citizen inquiries and complaints within 30 days of receipt of such complaints. When citizens appeal to the Secretary or Assistant Secretary after receipt of Area Office responses, the Central Office shall respond to such appeals within 30 days."

(8) ENFORCEMENT OF RELATED STATUTES AND EXECUTIVE ORDERS.

104(d). Add new section 104(d)(3) after end of current 104(d)(2), as follows:

"HUD review and enforcement shall encompass the Hatch Act, civil rights provisions governing fair housing, equal employment opportunity, the Architectural Barriers Act, and the Uniform Relocation Act."

(9) UDAG

BALANCE BETWEEN ECONOMIC DEVELOPMENT AND NEIGHBORHOOD/HOUSING PROPOSALS.

Section 119(a). Add to end of first sentence the following:

"... and to assist in neighborhood development activities, including housing construction and rehabilitation."

LEVERAGING REQUIREMENT FOR HOUSING/NEIGHBORHOOD-BASED PROPOSALS.

Section 119(d)(1). Add the following:

"...In establishing criteria for leveraging ratios, proposals for neighborhood/housing grants shall not be required to achieve a ratio beyond one half of the ratio established for the balance of the program."

EXPENDITURES EXPANDED WITHOUT REGARD TO LOCATION OR BENEFICIARIES

Mr. BLOYD. Fifteen local monitoring groups, including El Paso's Campana Pro Preservacion del Barrio, found that the 1982 CD program, moved measurably toward a revenue-sharing orientation, in which public works expenditures were expanded without regard to location or beneficiaries. Economic development project funding increased without targeting of jobs or training for area residents, and the use of the newly required statements of objectives undercut the principal benefit objective of the law.

The working group report also found that HUD's demonstration rental rehab program contained features which encouraged displacement and HUD was slow to carry out its grantee performance and the monitoring obligations. In documentation of these trends, I cite three statistics from the report.

Out of a total of 117 local objectives analyzed by monitor groups such as Juan Montes' group, only 39—exactly one-third—demonstrated a clear reference to low- and moderate-income needs. This finding could be expected in light of HUD's repeated interpretation that the benefit requirement takes no precedence over other purposes of the program.

Second, programs meeting priority needs of low-income residents were reduced or eliminated in one-third of those communities by an average of 24-percent reductions from the previous budgets. This reduction is approximately twice the average overall cuts faced by these jurisdictions in 1982.

Third, the 15 jurisdictions spent 21 percent of their funds on economic development projects, yet in most instances the projects' statements demonstrated no sign of comprehensive development strategy or commitments for jobs or training for area residents.

In light of the intense interest by Congress on this very day, I might add, in job-creation programs, and with CDBG slated as a major vehicle for these programs, it seems especially important that serious legislative and administrative oversight be focused on CDBG if it is to reach the structurally unemployed. We believe that the most of CDBG toward revenue sharing, this year, has been demonstrated sufficiently, and that it must be identified as a dangerous and wasteful trend—as much so as the formal proposal of the administration to merge CDBG and general revenue sharing.

With so many federally funded programs having been cut or eliminated, CDBG is one of the remaining resources for meeting housing and community needs of lower income neighborhood residents. Its dilution into a de facto revenue-sharing program represents an unacceptable further loss to these residents.

Let me speak briefly about problems of HUD's proposed entitlement regulations in respect to reauthorization. The first and foremost action we believe Congress needs to take to turn the revenue-sharing trend of CDBG around is for this committee to disapprove of HUD's plan for entitlement regulations in the forms presented thus far.

We further urge that serious attention be given to legislative corrections that will prevent the reemergence of such regulations in the future. HUD's proposed regulations would do the following: One, effectively kill the benefit requirement; two, open up housing rehabilitation for upper income residents; three, reduce the effectiveness of the antidisplacement protections in the current regulations; four, make it less likely that economic development projects will provide jobs for those needing them most; and five, permit special assessments to be levied against lower income persons when street and sidewalk work is financed with CDBG funds.

In approximately 12 communities, local ordinances or resolutions have been passed which provide continuing protections for citizen participation in targeting of the CDBG program. All these actions have proven valuable in those communities. The remaining 2,000-plus jurisdictions and State-operated programs have no such local protections. CDBG is of great potential value to low- and moderate-income communities, because of its flexible, decentralized nature, permitting local negotiations about the design and program choices for CD-funded projects.

But as my colleague, Mr. Montes, has demonstrated in his statement about the Segundo Barrio experience in El Paso, a Federal role in setting out the ground rules for such local negotiation is a critical factor if residents are to retain any hope of seeing the actual benefits of the program. When those ground rules are clear and are seriously and consistently enforced, the decentralizing of program planning, implementation, and evaluation does work. The working group's newsletter, the "CD Citizen," regularly cites positive experiences with the program, but most of those are premised on the local belief that the act is intended primarily to benefit low- and moderate-income residents.

We have submitted with our written testimony specific proposed amendments that would deal with the regulation concerns that we raised. These amendments come out of the community monitoring experiences in more than 100 jurisdictions throughout the country over the past 4 years.

They are intended to reaffirm the local-national balance to this decentralized program and the role of the Federal Government in establishing ground rules out of which an effective local program may develop. Such a program must be true to the primary objective of the act, and must foster local accountability. These amendments address the specific problems and confusion generated by HUD's proposed entitlement regulations. In several cases, they reflect language already incorporated in the current regulations which have been in force since 1978. They cover the following topics:

PROPOSED AMENDMENTS

First, clarification of the principal benefit objective. This includes the following: Addition to primary objective language; definition of "low" and "moderate" income; requirement of attention to low-income needs; local recordkeeping for calculation of benefit; affordability to and occupancy by lower income residents in rehab housing units; jobs requirements for economic development projects; neighborhood commercial facilities requirements; job commitments and job creation uses; grantee performance report information; loan guarantee programs, as part of HUD's review; HUD review obligations and procedures.

Second, these proposed amendments provide protections against displacement, as was so graphically described by Mr. Montes.

Third, housing assistance plan clarifications. These clarifications would uncover the inclusion of racial categories in required information—a category, by the way, that HUD proposes to remove in their draft of grantee performance reports. It also includes occupancy by lower income residents of rehabbed units, attention to substandard units and priority for vacant units. It includes neighborhood relocation provisions and statement of local actions to implement goals.

Fourth, these amendments would include prohibitions against special assessments.

Fifth, they will provide for required information which would include identification of projects listed in statement of activities, publication requirements, and an amendment process where program changes exceed 10 percent of the budget.

Sixth, the public access to record.

Seventh, complaint processes, local and Federal.

Eighth, enforcement of the related statutes.

Ninth, proposals on the UDAG program, which would include opportunities for neighborhood projects and for housing projects with reduced leveraging requirements to make these more possible.

The experience of the past year, especially since the introduction of HUD's proposed regulations in October, makes these amendments necessary in order to make clear what is the intent and purpose of Congress in seeing to it that CDBG shall primarily benefit low- and moderate-income persons. We believe that each of these amendments is a necessary element of such clarity. Further, they provide the basis on which local citizens can monitor their local program, and thus provide accountability close at hand. Such accountability will make the monitoring responsibility of HUD easier, and more effective as well.

We urge this committee to give serious consideration to these amendments and to the supporting documents and experience from which they come. Thank you for this opportunity.

Senator TOWER. Thank you, Mr. Bloyd. You have eliminated a problem we have actually been wrestling with for at least the 22 years that I have been in the Senate. In our zeal to help low-income and disadvantaged people, and our efforts to rehabilitate communities, we have failed to consider, I think, adequately this problem of relocation. This goes back to the old urban renewal program of years ago.

The ironic thing, as I think you underscore, is that sometimes we have imposed hardships on the very people that we thought we were trying to help in this process. Have you been in touch with people similarly situated in other cities than El Paso? It occurs to me that the problem you describe in El Paso is not just peculiar to El Paso; it occurs in other cities.

Mr. MONTES. Many other cities.

Senator TOWER. Let me recite a little history. We came around the idea of renveue sharing and/or block grants partially as a response to a number of public officials in municipalities all over the country who complained that the categorical grant-in-aid approach denied them the flexibility, the discretion, to order their own priorities, and to use funds where they were needed most. Sometimes, cities participated in categorical grants on matters of secondary priorities when they would rather have had the money for something that was a higher priority for that community.

I think what we want to do is to make sure that we preserve some element of local discretion and flexibility. I assume, by what you have said, we appear to be going too far in that direction now; that actually, in fact, there is now adequate local discretion and flexibility. I have even had some local officials say: "Look, I would rather have a little less money but have more discretion on how to spend it." This was in the past when we came to this idea of block grants as opposed to categorical grants in aid.

I would appreciate a comment, if you have one. Ms. Reynolds.

Ms. REYNOLDS. Thank you, Mr. Chairman. It is an interesting question, and it is a dilemma for us, too, at the local level. We fight the same battles on a slightly different scale. When the block grant concept was developed, CDBG in particular, the old Model Cities Program and a number of programs were rolled into one program. It was a great step forward, because there was less ability and priority making at the local level, but it was within a program area, a need area. You could look at housing, economic and community development, as a basically bricks-and-mortar community rehabilitation effort. That has worked very well.

Our concern in broadening that too much, to make it just general revenue sharing, one doesn't say "just general revenue sharing" when you are receiving it, because that also was very important, but the focus is necessarily lost. The national need that was recognized through a block grant to begin with, is somehow diluted into less of a national need. Operating budgets will take over the dollars from other community development needs.

I think my colleague here spoke eloquently about the barrio. Unless that money comes focused in on those particular problems, those problems are not likely to be addressed. If local governments were able to do that priority setting totally by themselves, then Congress would never have needed to address the problem at all. That was not the case before 1974. I doubt it will be the case after 1984, if we either discontinue the community development block grant program as a specific use area, or if we enlarge it to the point where we truly do set all of our own priorities.

There are national priorities. They are real and national in scope. It is a fine line to appreciate the problem, but I think your statement was most correct. Perhaps we are going too far now.

Senator TOWER. Let me recognize Mr. Scott, and then you, Mr. Montes.

TOP PRIORITY IS REAUTHORIZATION

Mr. SCOTT. Thank you, Mr. Chairman. Let me say first that one of NACO's top priorities is the reauthorization. We are very supportive of that program. We think it has been an excellent program. Similarly, we are anxious to see the community development program continue. We think it also has provided some opportunities for community improvement that have been, on the one hand, flexible; on the other hand, focused to the point that if it were competing in a general block grant program with general revenue sharing or as a part of general revenue sharing, some of the original purposes might be lost.

There are some administrative problems that we can perceive because of the peculiar situation of counties, and urban counties in particular, but we are also apprehensive about the change in the block grants program bit by bit to a revenue sharing—putting in one purpose, then another purpose, folding in one purpose, then another purpose, into the block grant program—and not providing additional funds.

What that means is, in particular, in the case of new housing construction, is a very large bite being taken out of the program which was designed for something else. We hope that we don't try to make the block grant program a housing program, exclusively. I think we are worried about that, as well as the problem of blending the general revenue sharing notion in with the community development program.

Senator TOWER. Mr. Montes.

Mr. MONTES. In the city of El Paso, CDBG has expanded to more than $60 million throughout the program. And the CDBG, because of the lack of clarification and the lack of definition on the part of Congress, of Congress intent, has been diluted.

CDBG money is general revenue sharing, anyway. As I said in my statement, the money that was intended for the poor people is not getting to us. What you have to say is, "Sure, give the cities discretion in their use of funds. But spell out that the CDBG program is a poor people's program, and not to be used in streets and parks and all of the other general accoutrements of downtown revitalization where it is being used. Is this a poor people's program or is it a general revenue sharing program under the name of CDBG?"

Senator **Tower**. Mr. Thomas.

Mr. **Thomas**. Mr. Chairman, you have hit on a fundamental point in the CD program, as well as in many other Federal programs that are used by cities. That is, how do we strike a reasonable, efficient balance between local control on the one hand and national purpose on the other? As we debate nationally the responsibilities at various levels of government, we are going to have to look at that argument closer and closer, because if we are going to cut expenses, we have got to target better, and target the need, and the function.

On the one hand, there has got to be a national purpose that can be supported not only this year but in years to come, and we think that we have that in the community development block grant program. In the primary targeting, low- and moderate-income people, there may come a day when the finances get too tough. Mr. Bloyd sort of castigated, called us down, for not mentioning in our original remarks that we were in favor of the targeting of the CD program.

But Ms. Reynolds and I both testified recently before the House Subcommittee on Housing about the CD regulations, and we were both strong in opposition to a weakening of that principal benefit philosophy. Over the years, I think most communities have handled these matters with good will and have built a substantial amount of capacity. As capacity is built, it seems to me there can be more local control, and it is up to us as representatives of the mayors of the country and the counties and the cities of the country to see that we do, indeed, follow the philosophy of the targeted programs in our local operations.

I hope we have done that in my city. I am sure that the other representatives have in theirs, as well. Unfortunately, we occasionally run into jurisdictions that do not handle their programs with good will, and there has got to be some mechanism for seeing that they do. We would not lay all of that to a postaudit review. There probably should be some mechanism where when localities have questions, and I think we have been dealing with it long enough to know where the gray areas lie, that there be some mechanism that HUD could give some prior approval of some of the expenditures of the money.

Also, in any effort to set any percentages, if that is before the Congress—and I guess if you have the principal benefit theory, principal benefit means at least 50 percent—that that be spread, that that percentage requirement be spread over the life of the program, 3 years, rather than made a 1-year requirement in order for the locality to use maximum flexibility.

But I think the strength that I have seen in the mayors' organization, as well as in the NLC—and I hope Ms. Reynolds would support me on this—is that there is great support for that principal benefit philosophy from low- and moderate-income people and for the removal of blight for emergency conditions.

Mr. **Bloyd**. Mr. Chairman?

Senator Tower. Would you make the comment fairly brief, Mr. Bloyd, because my time is up.

Mr. Bloyd. Sure. I think what concerns us this morning is that there has been a record that has been established since October of HUD making it fairly clear how they intend to define the objective and the benefit requirements to deal with the gray areas that have been referred to, and our understanding, in responding to that, is that there has been a bipartisan concern by Senate and House staff, Democrats and Republicans, that they are not accepting of HUD's approach that they proceeded with.

It seems to us that at a time of reauthorization, it's very unreal not to address that record. HUD has said what they propose to do in renewing the program, and their proposals will seriously further gut the principal benefit requirement.

We cannot ignore that record. They propose to submit some regulations which if this Congress does not reauthorize in a different way will make for a very different, more general revenue sharing type program.

One additional piece. Part of their proposal says that they would like, as the mayor says, to review for benefit over 3 years, which appears to be very inconsistent. In 1981, the congressional amendments changed it from a 3-year plan, a 3-year program requirement, to an annual submittal of proposed activities, not necessarily connected from year to year.

It seems to us inconsistent not to have each program on its face, year by year, face the benefit requirement, when the Congress has already disestablished a 3-year plan and a 3-year program. The purpose to be achieved would be to make it much easier to achieve a benefit by spreading it over several years. We believe that is what the intent of the administration is in HUD, and that would seriously further gut the program. We think it's important that this committee comment, as these witnesses talk about what HUD proposes to do.

Senator Tower. Senator Lautenberg.

Senator Lautenberg. Thank you, Mr. Chairman. I am sorry I wasn't here to hear the testimony. I did get to review it beforehand.

PRESIDENT'S NEW FEDERALISM PROPOSAL

Mayor Thomas, under the President's New Federalism proposal, I assume you are aware that 20 percent of the CDBG funds could be folded into general revenue sharing. Is it correct, then, that the principal benefit test incorporated in the CDBG to assure attention to low- and moderate-income people would cease to apply to the funds folded in as well as other wage and environmental laws?

Mr. Thomas. That is my understanding.

Senator Lautenberg. How do you view this prospect?

Mr. Thomas. The Conference of Mayors met in January, right when these proposals were put forward. Secretary Pierce appeared before the standing committee of which I am chairman, and did not comment on this matter past a remark that he was in favor of the program, but hoped that it could be handled in a way to preserve the benefits to low-income people.

We feel very strongly that revenue sharing and CDBG were originally inaugurated for different national purposes, and we feel that those national purposes should be preserved, and that these programs be kept separate, and that the community development block grants, indeed, be targeted to principally benefit low- and moderate-income people. So our position is in opposition to the merger of revenue sharing and CDBG.

Senator LAUTENBERG. And, I assume, the panel's view on this is generally shared. There is no difference of views?

Ms. REYNOLDS. I think, for the National League of Cities, we certainly agree with the Conference of Mayors, and met as recently as 3 days ago to reaffirm that very position. We want flexibility, programmatic flexibility, but not a blank check, not a dilution of the Federal purpose.

Senator LAUTENBERG. OK. I was very interested in reading Mr. Montes' testimony and the subsequent testimony by your colleague there. I take it the thrust is—if I have missed it, I just want a clarification—is to make sure that the projects are targeted at the Federal level, or at the regional level, so that in some cases where there may be confusion at the local level that these funds don't get diverted into other projects.

Mr. MONTES. We would like to see Congress strengthen the language and make it very clear, to HUD, to the cities, and even to the courts, because of the way the CDBG program is being run HUD is impotent to give us administrative relief. The courts don't understand the issues at hand, so because of—the congressional intent, which is supposedly unclear—to me it's very clear, but I think you should spell out to the cities in the legislation that it is a poor people's program.

Senator LAUTENBERG. As I read your testimony—did you feel that you were penalized, or the barrio, or whatever the proper terminology is for that community, was penalized as a result of appealing for administrative relief, registering your complaints?

Mr. MONTES. Right after monitoring the CDBG program for about 4 years, now, we showed out the deficiencies in the existing CDBG program, as to the necessity of our community, and HUD in conjuction with the city said: "It's too much to deal with."

HUD allowed the city to remove our area as a neighborhood strategy area. Therefore, the CDBG money is no longer targeted to the neediest areas of the city.

Senator LAUTENBERG. The defintion of programs for the poor, low-income families—you see it as very specific, very narrowly defined? You have not thought of it as providing funds for downtown revitalization, or something like that. Do you see something like a firehouse or a treatment plant—you don't take those as that same definition?

Mr. MONTES. I believe—we even have developed some economic development projects in the barrio where the people are creating their own jobs, creating their own income, getting out of the dependency state. If you could come up with terminology to reflect economic development in that sense——

Senator LAUTENBERG. You are not talking about general community services, then?

Mr. **Montes**. I was going to use for an example, Mr. Tower announced in December that El Paso was being awarded a $6 million UDAG grant. That grant is good, but it's going to fund two parking garages, I think a total of about 400 parking spaces, $6 million for 400 parking spaces, as accoutrements to a downtown, revitalized, first-class hotel, and an office building for the El Paso Electric Co.

What the people can't understand is how the Housing and Urban Development people can be subsidizing the local utility monopoly and first-class hotels when the housing conditions are as they exist.

Senator **Lautenberg**. We're not reviewing the UDAG programs here.

Mr. Scott, in your testimony, you urged continuation of the section 108 loan guarantee program. The Senate Appropriations Committee has sent to the floor a bill with 1 billion dollars' worth of section 108 money in it. You favor that provision?

Mr. **Scott**. We definitely favor the continuation of the program; yes, sir.

Senator **Lautenberg**. How does that compare with what was done in the other body?

Mr. **Scott**. The $1 billion? As I understand it since the loan guarantee represents an advance on future funds, we support the $1.25 billion included in the House bill given this is new, additional money.

Senator **Lautenberg**. My time is up. Just in quick fashion, if I may. You support section 108. But it's not a replacement for the basic CDBG program.

Mr. **Scott**. That's right.

Senator **Lautenberg**. Thank you, Mr. Chairman.

Senator **Tower**. Senator Sarbanes.

Senator **Sarbanes**. Thank you, Mr. Chairman.

COMMUNICATION BETWEEN HUD AND COMMUNITY PEOPLE

Ladies and gentlemen, the first question I would like to put is a procedural one: You all represent recognized and established organizations, reputable, I would say, with a longstanding interest in these problems. To what extent did the Secretary and the Department discuss with you the proposals that have now been submitted by them on which you are commenting and in—which the Congress is now looking at?

Ms. **Reynolds**. If I might start with the National League of Cities, as always, when asked a real question, I refer to staff for a real answer. The answer is to the best of our knowledge we were not consulted before they were proposed.

Mr. **Scott**. Apparently, we were not, either.

Mr. **Thomas**. We take that same position.

Senator **Sarbanes**. Mr. Bloyd?

Mr. **Bloyd**. The Secretary rarely communicates with community people, and our testimony shows that there is no provision for that type of dialog.

Senator **Sarbanes**. Could I ask you this question? We had Secretary Pierce here before us yesterday. Is this absence of dialog and discussion a new departure in terms of what the practice has generally been over the years?

Ms. REYNOLDS. I will start off again. Communication is always a matter of individuals, and I have been in office through at least three Federal administrations, and I would say it has varied in character drastically depending on who the individuals are. Even with HUD, I think it varies department to department within HUD.

These are rather major initiatives. We have had longstanding dialog. I think I may have almost overstated it ourselves when we said "not at all," because with each of the discussions we have had with this administration the day they took office—the specifics of these proposals, however, were not, however, run through our shop before. It's not that we never talk to them, whether there is no communication, but the specifics were not brought to our attention. And that is a big change from the last administration, which was a big change from the administration before that; yes, sir.

Mr. SCOTT. I think that is a good statement of our feeling, too. I think their communication does change from time to time, and from leadership to leadership.

Senator SARBANES. I know that, and I don't want to do Secretary Pierce an injustice, but it is my perception—and if I'm wrong, I want to be corrected—that his willingness to discuss with responsible groups such as the ones you represent is less than any HUD Secretary that we've had under Democratic or Republican administrations.

Mr. SCOTT. My institutional memory is not as long as some. I haven't been around, I guess, for a real long time. So it would be real hard for me as an individual to make any long-range statement about that problem.

I can simply respond to the current situation, which was that we think that the dialog was inadequate. But if you would like some further response on that, we'd be happy to supply it to you, Senator.

Senator SARBANES. Ms. Reynolds, did you want to respond?

Ms. REYNOLDS. Mr. Todd reminds me that we did have some prior discussions, specifically on UDAG, before that proposal was brought forward under the latest round.

So there's not been a complete lack of communication. We did talk on that particular point before the fact.

Mr. THOMAS. The conference has had communication, also, with the Secretary and his assistants from time to time. I don't know that we feel it satisfactory as we would like. I have some feelings that some of the proposals that come from HUD may not have originated really in HUD.

So that the communication that we would have to have, even, with some programs, might have to be at some other level of government.

There have been meetings held. For instance, we attended one on the housing block proposal, public housing. And we haven't had any followup on that.

So I don't know any analysis I make to be a personal analysis of why we have not had that close communication. But it may be that budgetary considerations are driving policy considerations a little too much.

I must say that at the NLC meeting just the other day, the counselor, Edwin Meese, spoke to a group that was talking about the reauthorization of revenue sharing, and I felt that he was very open about wanting full communication with the representatives of the cities, inviting it, and saying that his office and the White House would respond eagerly to initiatives by the cities.

So we will continue on behalf of the Conference of Mayors to make those initiatives and to seek for avenues of better communication.

EXCLUSION OF RESIDENTIAL PROJECTS

Senator **Sarbanes**. On the UDAG, what is your view, and the members of the panel, on excluding of residential projects from qualified activities?

Mr. **Bloyd**. Senator Sarbanes, the communications we've had with groups similar to the ones that we worked with directly, are that it undercuts a real opportunity to do housing programs and do effective neighborhood work to supplement whatever else UDAG is doing.

And that if the leveraging requirements were changed, that this would provide another early source that would help cut back this huge backlog in the hundreds of millions, that hasn't been spent.

There's a tremendous backlog of expressed interest by nonprofit groups wanting to work with cities, to do neighborhood housing.

And UDAG would be a good vehicle for that, and they are frustrated by HUD's draft amendments, which would make it even tougher to do housing and neighborhood work.

Ms. **Reynolds**. Senator, the city of Denver got one of the first UDAG's, a $13 million UDAG for a mixed project, part of which is housing.

We have found that to be a useful tool. The National League of Cities is not supporting that sort of change in the law or in the regulations.

We've had a number of housing programs either substantially reduced or pulled all together, taking one more tool away. And a tool that can't be used, quite frankly, that often. We're talking about leveraging money, and working with the private side for profitmaking.

Housing is not always an attractive component. But taking that one more tool out of our bag for housing does not seem to us to be appropriate. No, sir.

Mr. **Thomas**. We would generally feel the same way. We don't want to exclude housing from the overall projects. But we would rather concentrate on housing in the housing program, rather than in the UDAG program.

Senator **Sarbanes**. How important is the lump-sum drawdown, and the loan guarantee program to your making the CDBG work effectively?

Mr. **Scott**. I think we have found it to be quite useful. I mentioned in my testimony the specific example in my county of a mobile home park that we would not be able to rehabilitate had we not had the section 108.

Senator **Sarbanes**. What do you think is the Secretary is trying to accomplish by abolishing both those provisions?

Ms. **Reynolds**. If I may, I don't mean to speculate on what the Secretary might or might not be thinking, but I think it goes along with a number of initiatives of the administration through HUD, having to do with everything from funding levels to recapture or deferment of funds. Things of that nature.

As to the lump-sum drawdown provision, that would simply mean that the Federal Government would retain the use of the money longer. The Secretary says there have been abuses in lump-sum drawdowns because they've been drawndown, and sitting in a local bank drawing interest. And not really used quickly.

That's not the purpose of the drawdown. If there are abuses, I suggest that they be sought out, and the proper chastisement be given for those abuses.

Those of us who have used those provisions effectively, however, would not care to have, again, that tool taken away because there is a perception of some abuse.

The advantages are obvious. To bring the money into the city, you want to go out to bid, you need to move, you don't have time to do the paperwork over and over, drawing things down slowly.

The loan programs are used ever more. This year there are more uses of that than in years past. It has been a very good way to double-leverage CDBG money by making the collateral loans that are necessary to get land for the projects. It's been a very useful tool.

It's not a costly tool to the Federal Government. Because the Federal Government is not responsible. I am, responsible, with my CDBG money, which is, I hope, coming to us anyway.

So we find that not even a very good budgetary argument.

Mr. **Bloyd**. If you intend to shut the program down, you wouldn't want to make future commitment. We would suggest that that would be a reason why the Secretary would not want to see a one-way loan proceed.

Senator **Sarbanes**. Thank you. I see my time is up. Thank you, Mr. Chairman.

Senator **Tower**. Mr. Trible, do you have anything at this time?

Senator **Trible**. Mr. Chairman, let me just say I apologize for my late arrival. I was chairing a meeting of the Commerce Committee on the NASA authorization. But for that responsibility, I would have been here to welcome the distinguished mayor of Norfolk, my friend, Vince Thomas; and Supervisor Scott, of Fairfax County.

I will review your testimony and the colloquy here this morning, and I'm sure to benefit by it.

And I would have no questions at this time, Mr. Chairman.

Senator **Tower**. I want to thank our panel for being here this morning. I think it's been very useful, and a very constructive discussion.

I think I can assure you all that we will carefully review everything that's been proposed by the administration.

You've made a very valuable input for us. Thank you very much.

Senator **Tower**. Our next panel is the panel on public housing. Our panel on public housing consists today of the Honorable Philip Abrams, Assistant Secretary and Federal Housing Commissioner in the Department of Housing and Urban Development; Mr. Ray Struyk, senior research associate at the Urban Institute of the District of Columbia; Mr. Robert Maffin, executive director of the National Association of Housing and Redevelopment Officials of Washington; Mr. Lewis H. Spence, representing the Council of Large Public Housing Authorities, and director of the Boston Public Housing Authority in Boston, Mass.

Gentlemen, we welcome you today as witnesses on a matter that is of enormous concern to us all. We will proceed in the order that I have named the witnesses, and I believe that we'll hear from all witnesses before we go to questions.

May I say, gentlemen, that you may submit whatever statements or appendices that you have for the record. They will be printed in their entirety in the record.

And if you'll summarize your statements, it will enable us to have a little more time for questions.

First, we'll hear from Mr. Abrams.

STATEMENTS OF PHILIP ABRAMS, ASSISTANT SECRETARY, FEDERAL HOUSING COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; RAY STRUYK, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE; ROBERT MAFFIN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS; AND LEWIS H. SPENCE, REPRESENTING THE COUNCIL OF LARGE PUBLIC HOUSING AUTHORITIES, BOSTON, MASS.

Mr. **Abrams**. Thank you, Mr. Chairman. I have submitted a written statement to the committee, which I would ask be placed in the record. And I'd like to make some oral comments.

Mr. Chairman, there are several issues that were raised in your invitation that are not covered in this statement. I'd like to just go over them briefly, and I'll try to hold my time to 10 minutes. Even though I'll be as brief as possible, I might need a few more minutes to be responsive to the requests of the committee.

The first question that was raised that I'd like to address is the condition of the public housing stock. We had various sources to rely on for that information.

The Perkins and Will study was conducted in 1979, and I'm sure it will be mentioned often today. It said that 7.4 percent of the units had major, chronic problems, and it looked into the modernization needs of the public housing stock as they existed at that time. That study is the basis for a lot of our judgments.

1979 HOUSING SURVEY

The next piece of data that we have that relates to that question is the 1979 annual housing survey, which shows that, with regard to the public housing stock, 10 percent of the stock is substandard and 7 to 8 percent of it is vacant. We believe that this 7- to 8-percent vacancy is made up of about 2 to 3 percent from turnovers as tenants move out, and 4 to 5 percent as a result of units being uninhabitable.

We have further a study, which has not yet been completed, conducted by our Office of Policy Development and Research. We have only preliminary information based on a survey of 556 projects in 26 housing authorities in 18 States, representing 14 percent of the total public housing stock. In the survey, we considered housing authorities of varying sizes, financial conditions and geography, the local housing market, and the age, type and condition of the housing stock. And we came up with some preliminary conclusions.

I think the most significant conclusion is that 92 percent of the housing stock can be saved, either as is or with modernization funds targeted to overcome energy conservation problems or problems related to substandard units. Of the balance, 8 percent, it would be appropriate, in our estimation, to either sell or retire that housing stock for a variety of reasons. This study was based on an evaluation of the local community and its ability to provide affordable and available housing for low-income families. So every one of those sources said that about 8 percent of the housing stock was no longer viable. Our recommendation was based on a number of criteria that show that there were multiple and hard-to-remedy conditions that existed in those projects. Many of them are in the category of having had 25 percent or more vacancies for some time, and they are regarded as being troubled by the housing authorities themselves. In many cases, the tenants are subject to a high crime incidence in their neighborhood, and some of their buildings have uncorrectable structural and site problems that could cost over $1 billion to correct.

I'd like to move on, and use the two charts that we've brought today from Housing and Urban Development, to go through our proposals for revising the public housing performance funding system, and the means of providing operating subsidies and modernization funds to the housing authorities. If the chart on my left and your right is readable by the members of the committee, you will see that the left box shows our evaluation of where the system stands at this point.

We have our current system of performance funding based on historical costs that were taken from the midseventies and have been inflated in various ways by inflation factors ever since then. In determining the needs under the performance funding system, if the housing authority was mismanaged in the midseventies, their performance funding system is based on that same inefficiency and high cost. On the other hand, if a housing authority was well-run, then they're held to their historical costs as captured in the midseventies.

If a unit was energy inefficient, then we continue to fund on the basis of that energy inefficiency. And we continue to fund on the basis of the midseventies when we as a country were in a different energy mode.

There's no incentive in that system to prevent deterioration of the stock. That has resulted in a number of substandard units, as I've said, throughout the public housing stock, as well as a great many vacancies. And we don't have incentives built into the system to encourage housing authorities to keep that Federal investment occupied by low-income families.

The system as it stands now has a modernization program that generates unlimited modernization demands. Year after year, we get requests for, and in many cases, grant requests for modernization which go far beyond what is the definition of safe and decent housing.

With regard to the public housing authorities' perspective on funding, the current system leads to budget uncertainty for Congress and for the housing authorities, because the system changes. It's a moving target, and no one can predict now what the estimates will be for 1984. We're not even sure about 1983, and we won't be until later this year.

We want to get to the box on the far right, which is a reformed system that's based on costs in the private market. It provides money based on the fair market rents which are used in the section 8 existing certificate program, which are localized in the private market, and which reflect the costs of providing housing in the private sector for low-income families. It provides for a replacement allowance, which would allow the housing authority to make normal repairs on an ongoing basis, and it provides for rents which reflect what the private sector is paying for utility costs.

This reformed system would encourage sound management. It would, in fact, for some of the housing authorities, eliminate HUD intervention and redtape in the day-to-day operations of the housing authority, which we believe is appropriate for those who will function under this system.

It will promote energy efficiency by not recapturing from the housing authority any savings in energy consumption or the cost of energy they purchase, and it will give incentives to maintain the public housing stock, because we will no longer subsidize vacant or substandard units.

It emphasizes local management decisions and pretty much sets free the housing authorities who are operating under the market rent system. It will provide credible budget requests, which we will be able to project, as we project the fair market rents and apply the CPI to increase those rents as local market conditions increase from year to year. It will give the public housing authorities a stable source of funds and an understandable and predictable funding system for public housing.

In order to get from the box on the left to the box on the right, we need the arrow in the middle. We are going to go through a transition period, particularly for those housing authorities that will get less money under this system than they would have gotten under the historical performance funding system.

Under this system, a housing authority gets the fair market rent for each category of units times the number of units that are occupied and meet housing quality standards. Housing authorities that, under that formula, would get less money than they get under the PFS, including adding 20 percent for a replacement allowance, would be phased down during the transition period and have a reduction from the performance funding system level of no more than 5 percent per year.

But because the new system includes a replacement allowance, almost all housing authorities would get more money in total under this system than they get under the current performance funding system. In fact, our budget request for operating subsidies under the new system, including replacement allowances, is for

$1.636 billion, as opposed to a PFS-driven demand, which would be about $1.4 billion.

This new system will provide for an orderly transition where housing authorities are not able to exist under the fair market rent system. It completes catch-up modernization by using transition modernization funds for projects that have substandard or vacant conditions.

We are proposing $3.5 billion in budget authority over this transition period for these transition housing authorities, so that they can become more efficient in terms of their physical stock, as they gain control of their management under the fair market rent basis. And that exercise of modernizing and doing energy conservation improvements for those buildings would cut costs, as it cuts energy consumption and provides incentives for the housing authorities to improve their management. That, as a fast overview, supplemented by the detail in my statement, deals with the basis of funding.

I would like to turn to the chart on my right and your left, which looks at the impacts of the replacement allowance as it relates to modernization, and our proposal to eliminate the modernization program after this transition period.

The line at the very top is from the Perkins and Will study that I spoke about earlier, which projected the modernization demand at what Perkins and Will calls level 3, which is above the minimum property standards for multifamily housing. I guess this standard can best be defined as what would be necessary to bring the projects up to section 8 new construction standards. Level 2 includes a lot of amenities that we don't believe are necessary, and that we don't believe are provided for low-income families in the private sector, particularly through our certificate program that is serving over 700,000 families. That level of demand, level 3, totaled 18.05 billion in 1984 dollars. All these numbers are in 1984 dollars, and they deal with the loan authority or the actual capital costs, not budget authority or contract authority.

The lower line indicates the actual capital cost of bringing all the units up to the standards that we set under the section 8 existing certificate program, which are housing quality standards set for safe and decent housing under that program, plus the needed catch-up modernization to do energy retrofits, to make the buildings more energy conservative, and eliminating the problem projects which I spoke about at the outset. With these housing quality standards, we have a total demand for modernization in 1984 capital cost dollars of $5.17 billion.

If you look at the green line down at the bottom, modernization funding since 1980 started at a level of $700 million and has increased each year. We had somewhat of an anomaly for 1983—which we are grateful to the Congress for providing because we think those funds are necessary—which gave us $2.589 billion in 1983. Then we have transition modernization requested from 1984 through 1987, which totals $3½ billion, and which would bring us above the $5.17 billion line to $5.6 billion.

When you add to that the replacement allowance—which would be included in the new funding system and which would allow housing authorities to schedule and make judgments, without HUD supervision, over what major repairs, deferred maintenance, structural improvements, or even set-asides for future acquisition would be done when you add that replacement allowance, then you come up with the red line, which brings you up to a level of $7.3 billion. This is well above the level that you would derive from the Perkins and Will study, as modified by using section 8 housing quality standards.

This is a very complicated proposal, and it hasn't been dealt with lightly. It has received attention from all levels of the administration and a great deal of attention from the Secretary, who has monitored the process that we have undergone for the last 2 years.

In reviewing exactly what the problems are with public housing, the study that was submitted to the Congress 1 year ago, in response to the request for evaluation of alternatives to the public housing operating subsidy system, was used as a starting point for these evaluations and these conclusions.

SENATE BILL 2607

Finally, you asked us to comment on Senate bill 2607, the authorization bill that came out of this committee last year. We have been generally supportive of the language in that bill as it regards public housing operating subsidies.

We have made some suggestions to the committee staff which would accommodate that approach to the fair market rent based operating subsidy system. Our suggestions would take into account those housing authorities which are designated as market rent housing authorities, and which would receive a fair market rent based subsidy, and would regard the tier B housing authorities as those which are in transition to becoming market rent housing authorities.

We would look upon those transition housing authorities in two different categories: First, those that are suffering from a reduction in the performance funding system amounts, even though they are getting more money when the replacement allowance is added, and we would suggest that they be monitored by HUD. We would place in another category those housing authorities that have serious management problems where direct action is needed by them and by HUD, and we would use the moneys that you have included in the bill for technical assistance for those housing authorities.

There are some other objections which we as an administration would have in terms of 3-year funding instead of 1-year funding, since the administration as a matter of policy is not in favor of having multiyear funding for programs such as this. I would note that the level of funding indicated in the Senate bill of $4¼ billion for 3 years relates to our current projection of the PFS demand, which is $4.5 billion for fiscal years 1983–85.

Our projections are based on the administration's proposals, which would increase tenant rents as well as adjust the public housing stock in consideration of those projects that we think should be retired.

And finally I would note that our proposed system for performance funding, combining the fair market rent basis with a replacement allowance would total $1.636 billion, which is almost $400 million more than what the bill last year proposed—understandable, because ours includes a replacement allowance.

I would end by pointing out that our proposal is not a budget-cutting exercise. If the administration wanted to use public housing as a vehicle for cutting deficits, we could continue what we have been working with the Congress and the housing authorities to do over the last 2 years, which is to try and take the existing system and modify it so that we can come up with cost-effective ways of managing public housing.

We don't think that public housing will benefit any further from that kind of tinkering. We believe that what is needed is a whole new approach to the funding of public housing, one that is based on a predictable system that gives the proper incentives for management and that will improve the life and living conditions of the tenants in public housing.

Thank you, Mr. Chairman.

[The complete statement follows:]

STATEMENT OF

PHILIP ABRAMS
ASSISTANT SECRETARY FOR HOUSING - FEDERAL HOUSING COMMISSIONER

Mr. Chairman, I am pleased to appear before the Subcommittee to discuss the Administration's proposed reforms in the way that Federal assistance is provided for public housing operating cost and modernization needs. Just yesterday, Secretary Pierce gave you an overview of the full legislative program for Fiscal Year 1984. My purpose today is to expand upon the Secretary's remarks in this one area -- to give you more information on the problems with the present funding system, to describe how the new system would work, and to indicate how public housing agencies and their tenants would be affected by the new system.

The purpose of our proposed reforms is to establish an objective standard for determining the annual amount of Federal subsidy required by each PHA, and to provide PHAs with greater managerial flexibility and control in using the Federal subsidy to operate their public housing programs.

The need for major reforms in our approach to financing the ongoing costs of public housing operation has become evident in recent years, as both the level of subsidy costs and the amount of Federal control have increased dramatically. Both the Congress and the President's Commission on Housing have called for changes in the funding system. In the Housing and Community Development Amendments of 1981, the Secretary of HUD was directed to review the present operating subsidy formula, including "alternative methods for distributing operating subsidies which provide incentives for efficient management, full rent collection, and improved maintenance of projects ..." In response to this directive, Secretary Pierce sent a report to the Congress in May 1982 entitled "Alternative Operating Subsidy Systems for the Public Housing Program." The proposal I will describe to you today is based on the findings and conclusions of that report.

THE PRESENT FUNDING SYSTEM

Before describing our proposals, I want to briefly review how the public housing program is now funded, and what the problems are with the present system.

Funds to construct and modernize public housing projects and to pay the related debt are provided to PHAs by the Federal Government in accordance with the terms of an Annual Contributions Contract. The ACC payments can be thought of as mortgage payments that are made by HUD on behalf of the PHA. After the debt is paid, the PHA owns the project.

PHAs meet their day-to-day operating expenses from tenant rents, and, where these are not sufficient, from Federal operating subsidies. Since 1975, the Department has funded operating subsidies in accordance with a Performance Funding System, or PFS, based almost entirely on historical spending levels, and not subject to any external standards. A separate modernization program provides funds for deferred maintenance, major repairs, replacements and other capital improvements. The capital improvements in many instances have proven to be excessive. The modernization program is discretionary -- that is, PHAs receive these funds from HUD on the basis of a lengthy process involving applications demonstrating need. We are currently implementing regulatory changes to target these funds to rectify substandard vacant and energy inefficient units.

There are several fundamental problems with the current PFS approach and the discretionary modernization program:

- As I have already noted, operating subsidies are based entirely on historical data on PHA spending levels, and there is no objective external standard used to evaluate spending needs. PHAs that get higher subsidies incur higher costs, and there is little incentive to improve project management and reduce costs.

- Utilities are subsidized on the basis of actual costs. Here again, there are not adequate incentives to reduce utility costs, which are generally much higher than in the private market.

- While the modernization program has helped many PHAs in carrying out long-overdue repairs and the replacement of obsolete equipment, the uncertain funding and the complex and time-consuming nature of the program discourage efficient use of Federal funds.

- The artificial separation of routine maintenance and repairs from modernization activities prevents PHAs from making cost-effective tradeoffs between maintenance and capital improvements.

As a consequence of these problems, operating subsidies have grown from $28.3 million in Fiscal Year 1970 to $1.3 billion in Fiscal Year 1983. In addition, the modernization program in recent years has been funded at a level of $1.5 to $1.8 billion in budget authority each year, and $2.589 billion has been appropriated for this program in Fiscal Year 1983. Despite these major infusions of Federal assistance, it is clear that the PFS formula and the procedures for public housing modernization are not fulfilling the expectations for these programs as spelled out in the United States Housing Act of 1937.

PROPOSAL FOR PUBLIC HOUSING REFORM

The Administration's proposal would revise the present system of subsidizing operating costs and funding public housing modernization. Under the proposal, the amount paid to each PHA would be based upon the Fair Market Rents for the particular market area, which are the private market rents used by HUD in providing assistance under the Section 8 Existing program. Fair Market Rents would be set at the 40th percentile of rents for all existing units in the market area which meet the Section 8 Housing Quality Standards, except those built in the last two years.

The FMR approach provides an objective standard against which the costs of operating and maintaining public housing can be measured by HUD, the PHA, tenants, and the Congress. It is a standard which recognizes inflation in the costs of housing maintenance and operation over time, but will not be undermined by inefficient management practices. Although the Department has the authority to implement the new funding system under the current law, we are proposing that the FMR formula be incorporated into the statute, in order to assure that the agreed upon parameters will be stable and that future funding will be predictable.

The funding formula, which provides for a single payment for both operating costs and a replacement allowance, would be calculated in the following manner. Each PHA would receive the sum of the FMRs for the number of occupied, standard quality units of each size in its inventory, minus projected tenant rents, and minus debt service reimbursements received by the PHA from HUD under Annual Contributions Contracts. The debt service deduction for each unit would be limited to 20 percent of the FMR, in order to ensure that PHAs do not lose new buildings from the stock and they have as much income available for expenses other than debt service as private owners of older rental housing. Where tenants pay their own utilities, an amount for tenant utilities is also subtracted. Vacant or substandard public housing units would not be eligible for subsidy under the FMR formula.

FMRs for high-rise family projects (those with six or more stories) would be set at 118 percent of regular FMRs; this procedure adjusts for the costs associated with these units, as high-rise family units are not typically found in the private market and they do present unique operating costs. In addition, the Department is considering other possible adjustments to assure the adequacy of the FMRs.

For each PHA, the amount of subsidy determined in accordance with this FMR approach would be compared with the amount the PHA would receive under the current PFS formula, plus a replacement allowance calculated at 20 percent of the current non-utilities operating costs. For many PHAs, this comparison would provide the PHA with a "windfall" due to the prior Federal payment for physical plant--that is, more subsidy under the FMR formula than under the PFS formula plus the replacement allowance. Where this occurs, the PHA's subsidy would be based upon the lower (PFS-based) amount in 1984. In 1985 and subsequent years, these PHAs would receive funding based on their 1984 level, plus an annual adjustment which reflects the extent to which FMRs have increased. For other PHAs, the FMR formula would give the lower amount, and in these cases, the PHA's subsidy would be based upon the FMR calculation. These PHA's are referred to as "market rent" PHA's.

PHAs will be classified as "transition PHAs" if their FMR-based subsidy would be less than the subsidy available to them under the PFS formula plus the replacement allowance. PHAs could experience such a reduction in subsidy because the new system will not pay for vacant or substandard units, or because some PHAs have subsidy levels under the PFS plus replacement allowance for occupied, standard units that exceed the FMR formula. Transition PHAs would receive at least 95 percent of the total operating funds that would have been available to them in 1984 under the PFS formula plus the replacement allowance. This transition funding level would be phased down in 1985 and subsequent years until the PHA's market rent subsidy level is reached.

We are also proposing a total of $3.45 billion in budget authority for a transition modernization program over the next four years, including $1.4 billion in Fiscal Year 1984. These modernization funds would permit the transition PHAs to bring their public housing stock up to standard condition and make energy-saving capital improvements. This procedure will help to reduce utility and maintenance costs for these PHAs so that they can operate successfully under the new funding system.

I want to stress that a key element in our proposal is to replace the present modernization program with the replacement allowance, which would be part of the new subsidy level paid to PHAs. Because the replacement allowance would be under the PHA's control and not subject to shifting Federal priorities, PHAs will be able to plan for the most efficient use of their resources to carry out a total program of project maintenance and continuing capital improvements.

IMPACT ON PHAs AND TENANTS

Under the Fair Market Rent system we are proposing, the amount of subsidy received by any PHA would depend on whether its operating cost levels are greater or less than the operating costs of private rental units in the same market area. In order to estimate budget needs and to determine the impact of the new system, HUD has evaluated data from a sample of the 1,200 PHAs with 100 or more units. Based on this sample, about 91 percent of these PHAs (with approximately 675,000 units) would receive the same subsidy as under the PFS formula, but in addition, they would receive a guaranteed replacement allowance to assist them in meeting future repair and replacement needs. In addition, there are over 1,600 very small PHAs (those with less than 100 units), and it is expected that virtually all of them would be capped at the PFS level plus the replacement allowance. Another two percent of the 1,200 PHAs (with 30,000 units) would receive the FMR-based subsidy from the outset.

The remaining seven percent of the PHAs (with about 285,000 units) will receive reduced subsidies because their 1984 PFS plus replacement allowance is larger than the FMR calculation. These PHAs are assured that, in 1984, they will receive at least 95 percent of the total operating funds that would have been available to them using PFS formula plus the replacement allowance. These transition PHAs will continue to phase-down in subsequent years until their subsidy is at the FMR level.

Some PHAs will be able to improve their operations by removing units which cannot be rehabilitated in a cost-effective manner. At this time, we expect that some 100,000 units where affordable low-income housing is available in the community will be eliminated from the public housing inventory, either through sale or demolition, over the next few years. I think it is important to stress that the removal of these units from the inventory is not a result of the new funding system, but would occur under any operating subsidy system.

I believe that this new funding system would benefit public housing tenants, because it is a system which rewards efficiency and effectiveness in project management and results in improved living conditions for the tenants. In addition, replacing the current modernization program with a replacement allowance means that all decisions on the use of these funds for repairs and replacements can be made expeditiously at the local level, where tenants can voice their opinions on what work items are needed.

During the early years of the new funding system, we will spend significantly more for operating subsidies to public housing than we would have spent under the PFS. This increased funding level represents a significant commitment to the program. Because the system encourages better PHA management and permits more effective use of available resources, Federal savings will occur in the out-years.

In summary, we believe our proposed changes in the funding of both operating and capital costs of public housing will establish reasonable and objectively measurable bases for future funding, create stability in resource levels, permit greater flexibility in PHA planning and budgeting, and strengthen the program.

Mr. Chairman, this concludes my prepared remarks.

Senator TOWER. Thank you, Mr. Abrams.

Mr. Struyk.

RAY STRUYK, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE, WASHINGTON, D.C.

Mr. STRUYK. Thank you. As part of the committee's invitation for me to testify today was a request that I concentrate on two areas—the specifics of administration's FMR system for public housing and possible ways to improve the existing performance funding system.

In the following, I will briefly discuss these two areas; first, the administration's proposal.

At the outset, let me say that in principle I think the FMR system is superior to the present one. However, the details of an FMR system are critical to its successful implementation.

The administration's proposal has several serious defects that must be remedied before the FMR system should be considered as a replacement for the PFS.

I believe that the FMR level proposed is incorrect. The central idea behind the FMR system is that authorities should be able to provide housing at the same cost as their private market counterparts.

Specifically, this implies that the rents used as the standard in the section 8 existing program should be applicable to public housing. Unfortunately, I believe that the 40th percentile FMR's are too low for the section 8 program to achieve its basic objective of inducing households living in deficient dwellings to arrange with their landlords for improvements or to move to better housing.

Thus, the section 8 FMR should be raised. I believe that this higher standard will be appropriate for public housing.

The "no winners" provision is wrong. The administration's proposal limits payments to any PHA under the FMR system to the amount received under PFS plus a replacement reserve. In effect, no authority can receive more under the FMR system than under PFS.

This feature appears to be, frankly, an expedient to hold down system cost. Several groups of PHAs certainly deserve higher payments—those whose PFS base year levels were underestimated, those who have been undercompensated for inflation over the years, and those whose utility bills embodied in the PFS comparison are low because they have been successful in controlling consumption.

Still, massive increases over PFS amounts are inappropriate, and they should not be needed. A limit on the increase in total funds available to authorities of 20 to 30 percent would seem to be in the correct order of magnitude.

There are also problems with the replacement allowance proposal. For those authorities whose funding under the FMR system would exceed that under PFS, the replacement allowance is a key factor in determining the payment under the FMR system.

HUD proposes setting it at 20 percent of the nonutilities operating expenses, based on a recently completed study of private replacement expenditures.

A couple of observations are pertinent here. First, a minimum dollar amount of funding should be established. Presently, some PHA's would receive less than $15 per unit a month, or $180 per unit a year, to fund all improvements and replacements after the transition.

Second, the 20-percent figure does not have a strong analytical base. It comes from a single year's observation for 300 FHA-insured projects, and since few of these projects were refinanced in that year the amount of improvement occurring with refinancing is not clear. Moreover, there is a great deal of variation around the 20-percent figure among these 300 projects, indicating that the figure itself is not very reliable.

Here in this uncertainty HUD should give the benefit of the doubt to the authorities and raise the replacement reserve figure.

Finally, one must ask what is the transition modernization program that the administration has in mind. The idea that authorities should be placed on a level playing field by eliminating the backlog of modernization requirements has wide endorsement, and it is an integral part of the FMR system.

Naturally, the details of the program must be known to evaluate it. Unfortunately, until this presentation today, the administration had been unwilling to explain exactly which standards it had in mind.

Moreover, there are still some questions here about, for example, what is the level of energy retrofit that they have in mind? Is there a 5-year payback period, a 5-year, a 10-year? All these different standards are floating around.

The funding levels, the $3.8 billion that has been proposed, looks to me to be too low to pay for a basic program involving weatherization investments with a 5-year cost recovery period plus general improvements to bring projects up to most of the criteria in the minimum property standards.

The FMR system should not be accepted without a realistic transition modernization program.

Now, let me address the upgrading of the performance funding system. The PFS has been justly criticized for technical flaws, administrative complexity, and embodying weak incentives for good management. However, if an FMR system is not adopted, much could be done to improve the PFS.

The first area is improved administration. There are three clear targets here.

First, introduce ex post reconciliation of inflation adjustments. We have known for several years that there are large errors in the predicted inflation factors provided by HUD to the PHAs.

In addition, the errors tend to be systematic so that some authorities are consistently over- or underfunded. This clearly leads to cumulative inequities among authorities.

This problem can be solved by making adjustments after the fact for actual inflation rates.

Second, improve the ability to adjust for changes in operating conditions. Authorities should be given the opportunity on a 3-year cycle to present evidence in a predefined set of areas that their operating conditions have changed so as to make operations more expensive.

A panel of senior public housing program officials would consider the evidence and make the determination. This process would allow us to rid ourselves finally of the problems of poor base year data and inappropriate inflation adjustments in the past.

Third, simplify the system. Start by dropping the so-called delta adjustment but look for other areas as well.

The second area of concern is the modernization program. The most profound weakness in the PFS is the lack of linkage between current operating expenditures and modernization; likewise, the actual allocation of mod funds. There is an administrative nightmare of restrictive regulations, grantsmanship, and area office predilections.

Adopt the transition modernization program for the FMR system that will erase the backlog of work to be done and in future years allocate modernization funds to authorities on a formula basis.

The third area is to build selective management incentives into the funding formula itself. The PFS formula can easily accept the addition of incentives to improve performance.

In determining which ones to include, the rule should be to consider only those for which there is an objective standard against which to measure performance. Monitoring performance is practical, and performance is relatively little affected by the operating environment.

Candidates that I have examined which meet these criteria include increasing sources of revenue, better checking on tenant incomes, and the use of project-based budgeting.

Beyond these changes, one other should be pursued. Badly distressed authorities must be helped to get back on track. Singling out two or three PHAs each year for major constructive intervention is probably required and feasible.

Selection of these authorities must be carefully made and, more importantly, the comprehensive interventions done in a positive and sensitive way so that valuable staff present in the authority are not demoralized and depart the scene altogether.

In closing, I want to emphasize my belief that a properly fashioned FMR system is superior to any system that treats public housing in complete isolation from the experience of publicly managed housing.

Ultimately, under a PFS or similar system there is no check with reality. This is neither healthy for the PHA's, nor does it permit rational decisions about program funding levels, which projects to retire, or other fundamental questions.

I hope the flaws in the administration proposal can be overcome and that an FMR system can be adopted. If this is not possible, upgrading the PFS is certainly in order.

[The complete statement follows:]

Testimony of
Raymond J. Struyk *

As part of the Committee's invitation to me to testify today was the request that I concentrate on two areas: the specifics of the administration's FMR-system proposal for public housing and possible ways to improve the existing Performance Funding System (PFS). In the following, I briefly address these two areas, assuming that the Committee has a working knowledge of the FMR-system proposal and the PFS.

The Administration's Proposal

At the outset let me say that in principle I think the FMR system is superior to the present system. However, the details of an FMR system are critical to its successful implementation. The administration's proposal has several defects that must be remedied before the FMR system should be considered as replacement for the PFS.[1]

The FMR level is incorrect

The central idea behind the FMR system is that authorities should be able to provide housing at the same cost as their private market counterparts. Specifically, this implies that the rents used as the standard in the Section 8 Existing program should be applicable to public housing. Unfortunately, I believe that 40th percentile FMRs (when combined with the changes in tenant contributions enacted in 1981) are too low for the Section 8 program to achieve its basic objective of inducing households living in deficient dwellings to arrange with their landlords for improvements or to move to better housing. Thus, the

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[1] The arguments sketched here are discussed much more completely in R. Struyk, Reforming Public Housing: An Early Analysis of the Administration's 1983 Proposal (Washington, D.C.: The Urban Institute, Project Report 3115-14-1, 1983).

* Mr. Struyk is a Senior Research Associate at The Urban Institute. Preparation of this testimony was supported by a grant from the Aetna Life and Casualty Foundation. The views expressed are his own and not necessarily those of the foundation or The Urban Institute.

Section 8 FMR should be raised. I believe that this higher standard would be appropriate for public housing.

No winners is wrong

The administration's proposal limits payments to any PHA under the FMR system to the amount received under PFS plus a replacement reserve. In effect, no PHA can receive more under the FMR system than under PFS with the modernization program. This feature appears to be a frankly expedient way to hold down system cost. Several groups of PHAs certainly deserve to receive higher payments: those whose PFS base year level was underestimated, those who have been under-compensated for inflation over the years, and those whose utility bills embodied in the PFS comparison are low because they have been successful in controlling consumption. Still, massive increases over PFS amounts are inappropriate, and they should not be needed. A limit on the increase in total funds available for PHAs to spend (not subsidies) of 20-30 percent would seem correct.

Problems with the replacement allowance

For those authorities whose funding under the FMR system would exceed that under PFS, the replacement allowance is the key factor in determining the payment under the FMR system. HUD proposes setting it at 20 percent of nonutilities operating expenses, based on a recently completed study of private replacement expenditures. A couple of observations are pertinent here. First, a minimum dollar amount of funding should be established; presently some PHAs would receive less than $15 per unit monthly or $180 per unit yearly to fund all improvements and replacements after the transition. Second, the 20 percent figure does not have a strong analytical base. It comes from a single year's observation for 300 FHA-insured projects; and, since few of these projects were refinanced in that year, the amount of improvement occurring with refinancing is unclear. Moreover, there is a great deal of variation around the 20 percent figure, indicating that this figure is not very reliable. Given this uncertainty, HUD should give the benefit of the doubt to the PHAs and raise the replacement reserve figure. (One standard deviation would be a reasonable starting point.) The department should also develop a more precise estimate of this factor.

What is the Transition Modernization Program

The idea that authorities should be placed on a "level playing field" by eliminating the backlog of modernization requirements has wide endorsement, and is an integral part of the FMR-system. Naturally, the details of the program must be known to evaluate it. Unfortunately, the administration has been unwilling to explain exactly which standards the $3.8 billion in funds for the FY1984-88 period embodies. The funding level looks to me too low to pay for a basic program involving weatherization investments with a five-year cost recovery period plus general improvements to bring projects up to most criteria in the minimum property standards. The FMR system should not be accepted without a realistic transition modernization program, that is one with adequate funding which gives authorities the maximum latitude in allocating their funds.

Upgrading the Performance Funding System

The PFS has been justly criticized for technical flaws, administrative complexity, and embodying weak incentives for good management. However, if an FMR system is not adopted, much could be done to improve the PFS, a good deal of it immediately. Still, some fundamental long-term work will be necessary if the PFS is to remain the system for allocating operating subsidies, and it will probably never be ideal. Let me now list the changes that could be made.

Improved administration

There are three clear targets for improving the PFS as it is presently constituted. First, introduce ex post reconciliation of inflation adjustments. We have known for several years that there are large errors in the predicted inflation factors provided by HUD to the PHAs. In addition, the errors tend to be systematic so that some authorities are consistently over or under funded. This clearly leads to cumulative inequities among authorities. This problem can be solved by making adjustments after the fact for actual inflation rates. Second, improve the ability to adjust for changes in operating conditions. Authorities should be given the opportunity on a three-year cycle to present evidence in a predefined set of areas that their operating conditions (exclusive of utilities) have changed so as to make operations more expensive. A panel of senior public housing program officials would consider the evidence and make the determination. This process would allow us to rid ourselves finally of the problems of poor base year data and inappropriate inflation adjustments in the past. Third, simplify the system; start by dropping the so-called "delta adjustment" but look for other areas as well.

Convert the modernization program to a formula allocation

The most profound weakness of the PFS is the lack of linkage between current operating expenditures and modernization. Likewise, the actual allocation of mod funds is an administrative nightmare of restrictive regulations, grantsmanship, and area office predilections. Adopt the transition modernization program from the FMR system that will erase the back-log of work to be done and in future years allocate modernization funds to authorities on a formula basis.

Build selective management incentives into the funding formula

The PFS formula can easily accept the addition of incentives to improve performance.[1] In determining which ones to include, the rule should be to consider only those for which (a) there is an objective standard against which to measure performance, (b) monitoring performance is practical, and (c) performance is relatively little affected by the operating environment. Candidates I have examined that meet these criteria include increasing sources of revenue, better checking of tenant incomes, and use of project based budgeting.

Beyond these changes two others should be pursued. Badly distressed authorities must be helped to get back on track. Singling out two or three PHAs each year for major constructive intervention is probably required and feasible. Selection of these authorites must be carefully made; and, more importantly, the comprehensive interventions done in a positive and sensitive way so that valuable staff are not demoralized by the process. The ideas in last year's Senate Housing Bill (S.2607) in this area deserve further consideration.

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1. These possibilities are detailed in Chapter 4 of R. Struyk and T. Thibodeau, Options for Funding Public Housing: Vouchers, the Fair Market Rent System, Upgrading Performance Funding (Washington, D.C.: The Urban Institute, Project Report 3084-1, 1982).

Finally, if the PFS is to continue in use, HUD must develop comprehensive data on PHA operations. Currently, there are dramatic differences between authorities in the amount of local support received --including CDBG funds and, more importantly, in-kind services such as police protection, and garbage collection. These are ignored in considering the relationship between performance and the cost of operations. Hence, it is impossible to know which PHAs are really running efficiently, and there is an urgent need for a stronger information base covering at least a sample of authorities.

Final Comment

In closing I want to emphasize my belief that a properly fashioned FMR system is superior to any system that treats public housing in complete isolation from the experience of privately managed housing. Ultimately, under a PFS or similar system there is no check with reality. This is neither healthy for the PHAs nor does it permit rational decisions about the program funding levels, which projects to retire, or other fundamental questions. I am hopeful that the flaws in the administration's proposal can be overcome and that an FMR-based system can be adopted. If this is not possible, upgrading the PFS is certainly in order.

Senator TOWER. Mr. Maffin?

ROBERT MAFFIN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS, WASHINGTON, D.C.

Mr. MAFFIN. I'd like to thank you and all the members of the subcommittee for allowing me to testify today. Since NAHRO is concerned with public housing operations and production, neighborhood revitalization and urban reinvestment we would like to submit additional material, Mr. Chairman.

Senator TOWER. Anything additional you'd like to submit will be included in the record.

Mr. MAFFIN. We applaud HUD's efforts to simplify the administration of the operating assistance program to provide predictablity in funding and provide for flexibility to local authorities in administering public housing programs.

Having said that, however, I want to strictly add that NAHRO believes that the road taken by the administration is an inappropriate and destructive one.

First, NAHRO supports a cost-based system of assistance to public housing agencies as the Congress suggested in 1974 and as the current PFS system provides. It can work effectively with the modifications we propose in our written testimony.

Second, the FMR system proposed by the administration rests on the assumption that rents effective in the private market are a sound basis for determining of operating subsidy needs for public housing.

The assumption, we believe, ignores contrary and overwhelming evidence. First, there is virtually no private unassisted rental housing being produced today except for the very upper end of the market. Second, for the most part, the private rental market in recent years has been characterized by conversion, abandonment or sale and repurchase, not for income but for tax shelter purposes.

Third, until the recent development of additional tax incentives, neighborhood revitalization, property rehabilitation and redevelopment efforts by the public sector, the private rental stock in the United States was deteriorating more rapidly than the housing stock as a whole—clear evidence, we believe, that the rent structure and the alternative investment sources available did not encourage long-term ownership, adequate maintenance, and modernization, all of which are not only goals but requirements of public housing.

Finally, if the system, the private rental market system works, why is it that we are now proposing a rental rehabilitation program to assist the private sector in upgrading the rental housing stock?

Actually, the FMR system proposed is not really that. The marketplace is being adjusted. It is being adjusted for high-rise developments, it is being adjusted for large family units, it is being adjusted for the winners and the losers in the proposed transition, but we don't know for how long. It arbitrarily assigns percentages to debt service and replacement and modernization.

These planned adjustments and arbitrary allocations signal the inappropriateness and hurried character of the proposal. The HUD proposal replaces a tested, though complicated, system with one which is inapplicable to the public housing stock and probably equally complicated.

It is, however, the basic assumptions that bother us the most. First of all, it is the assumption that the current system can be changed by regulation alone, if need be. Clearly, the standard set forth in the 1974 act and the cost-based factors of the 1974 act and the legislative history do not indicate that to us. Quite the contrary.

Second, using the 40th percentile has the effect of lowering the applicable fair market rents and thus assistance payments, particularly when you consider that recent movers and new construction are deleted.

Finally, lowering the standards and changing the priorities of the CIAP program for the short term presents some problems for us. For example, in using the HQS standards it is our understanding that recent updated data indicates that the cost of fixing up existing housing to meet the HQS standards of section 8 existing is around $485. Anybody in the rehabilitation and modernization business knows that there's precious little that can be rehabilitated for $485. Changing these standards, it seems to us, for the sake of comparability to section 8 existing is an inappropriate solution for public housing modernization.

Unlike the section 8, the tenant who can move, the public housing authority owns the housing, must maintain it and must modernize it. It's there, it has to be upgraded.

Finally, there are the dollars. The dollars are being reduced for operations and modernization. My recollection is that Congress appropriated last year amounts in the neighborhood of $3.9 billion for modernization and operations for public housing. The administration is proposing for fiscal year 1984 in the neighborhood of $3 billion. NAHRO suggests the continuation of the PFS formula will require about 1.536 for operations, if you delete the administration's recommendation that food stamps be counted as income and 2.5 for modernization.

The administration suggests that the fact that there will be no fewer losers by its proposal is an error. We cannot see how you can reduce the aggregate for operations and modernization by $800 to $900 million from one fiscal year to another, and not have everyone be a loser.

Our conclusion is that the proposal is driven by budget rather than reality. The real world of public housing modernization and operation, the dollars required, does not change by adminstrative fiat.

Thank you, Mr. Chairman.

[The complete statement with additional material follows:]

Statement of Robert W. Maffin
Executive Director
National Association of Housing
and Redevelopment Officials

Before the
Subcommittee on Housing and Urban Affairs

Committee on Banking, Housing and Urban Affairs
United States Senate
March 9, 1983

Mr. Chairman and members of the Subcommittee, I am Robert W. Maffin, NAHRO's Executive Director.

NAHRO, as you know, is an association of professionals who administer low-income housing, rehabilitation and community development programs in localities all across this country. We have been active as an association for almost 50 years and we represent over 6,000 individuals and 2,000 agencies involved in carrying out programs of housing and community development. I appreciate the opportunity to appear before you today to discuss public housing issues and present NAHRO's position on them. We represent all types and sizes of housing authorities in all parts of the country, and I think our perspective will be useful to the Subcommittee. Because of the range of our concerns in the housing and community development fields, I would like to submit, in addition to this testimony, a statement setting forth NAHRO's views on other housing and community development issues facing the Congress.

Let me state at the outset that NAHRO opposes the adoption of a fair market rent-based system for public housing as proposed by the Administration. While we will continue to examine that proposal, we believe that the kindest verdict that could be rendered on it today is "not proven." We believe the proposal threatens to wreak havoc on a system that contains some 1.3 million housing units and houses some 3.5 million people. If there is anything that system needs now it is continuity and stability, not the diversion of energies and resources that would certainly accompany fundamental and, we believe, ill-considered changes in the method of funding public housing operations. Let me put this rather harsh conclusion in perspective and present what we think are some constructive proposals for improving the management of our public housing resources.

Mr. Chairman, although it is easy to criticize public housing, it is still the best investment this nation has made in directly responding to the housing needs of low-income persons. If it did not exist, it would be quickly invented; it has no substitute. The best test of its usefulness is the continuing demand at the local level by low-income persons - its vacancy rates are extremely low, its waiting lists are extensive, and the need remains great. Even under a narrow definition of quality, HUD's annual housing survey show at least 7 million households living in substandard housing. This does not include those units which are deteriorating and reaching substandard status on a regular cycle. The production of rental housing in the private market has virtually ceased.

Short supply and low vacancy rates are putting tremendous pressures on the existing housing stock.

Focusing on the existing public housing stock, I do not think that we need argue the point of whether or not this is an important national asset. There are questions, however, about the operation and management of public housing that require our attention.

NAHRO members will be the first to state that the present system for managing public housing has many imperfections. One of the most troublesome aspects of this system has been the erratic nature of federal funding of operating subsidies. This together with related concerns and anxieties over constant changes in the regulatory treatment of public housing operations has led NAHRO to call for a multi-year authorization of public housing operating subsidies and a commitment on the part of the Congress to fund public housing operating subsidies at adequate levels and at timely intervals.

The fact is, Mr. Chairman, that what should be the model of a well-managed public asset supported by a realistic and reliable partnership of local and federal authorities very often resembles a guessing game with too few answers. Nationally, today, public housing operations are characterized by inadequate and unpredictable funding, a lack of realistic management incentives, and the absence of discretionary decision-making authority at the local level. These factors make our public housing programs something less than what they should be.

At the heart of the present federal/local system for the funding of public housing is the so-called "Performance Funding System." This complicated system embraces a set of assumptions and a formula for calculating the annual operating subsidies the federal government provides to local public housing authorities. The operating subsidy compensates them for the difference between operating costs and tenant rental revenues which results from the low-income nature of the population they serve, and from federal statutory limitations on the rent that can be charged public housing tenants.

Mr. Chairman, NAHRO and others have had problems with some aspects of the Performance Funding System since its inception, but we think there are steps that can be taken at this point in time which will result in modifications and improvements to the Performance Funding System, making it a far more useful vehicle for the funding of public housing operations. We note that Congress, in the 1981 Reconciliation Act, directed the Secretary to review the Operating Subsidy Program including "alternative methods for distributing operating subsidies which provide incentives for efficient management, full rent collection, and improved maintenance of projects." Has the administration accomplished this in its proposal? We don't think so. Can it be done? We think so! I have attached to my prepared testimony a copy of a set of recommendations NAHRO has made on improving the Performance Funding System and public housing management. These recommendations include reviews and potential updating of the base year calculation, replacement of the so-called "Delta Factor" with a simpler proxy for changes in operating conditions, year-end reconciliation of the allowable expense levels, and the establishment of management goals and incentives at the local level. These proposed changes in the Performance Funding System formula are outlined in detail in the accompanying paper. I would just like to say that I think if implemented they will go a long way toward correcting the inefficiencies and inequities of the Performance Funding System as it now operates.

NAHRO feels strongly that incentives must be built into the Performance System with two different, although related, objectives in mind. One objective is to make more efficient the operation of public housing authorities. The other is to produce savings in operating subsidies. Achieving the first objective may not, or indeed need not, produce financial benefits to the public housing authority. Where appropriate, incentives should be designed to increase savings to the PHA which in turn can be used by the PHA for the improvement of its housing stock and/or tenant services. The point is, Mr. Chairman, that NAHRO believes that it is a valid public purpose to improve the living environment for tenants, provide better services, increase the number of families served, and promote improved staff performance and higher morale. NAHRO does not believe that cost savings should be the only measure of a system designed to provide a public service.

What are the elements of an appropriate management incentive system for public housing authorities and how can they be institutionalized? Let me briefly highlight what I believe are the key elements of a successful program of managment incentives. First of all, a single national standard applicable to all managment objectives is not appropriate for PHA's because of regional, size, and local variations in the operating circumstances of public housing authorities. Rather, incentives should be provided so that all PHA's can move quickly to assess fully their particular management requirements, and undertake an orderly process of improvement, including a reduction in federal regulations. Working cooperatively with their HUD area offices, local housing authorities can devise and carry out management plans related to their special needs. However, it should be recognized that identification, installation, and pay-back of new management approaches requires lead time. Endorsement and support of a public housing authority-based self-assessment and incentive system by the Congress and the Department of HUD would greatly expedite the achievement of long-sought management goals.

Secondly, NAHRO does not believe that the granting of more or less operating subsidies as a reward or punishment is the most effective motivation to achieve all management goals. Most management objectives are achieved in increments, making it difficult for public housing authorities or HUD to set an objective bench mark, the obtaining of which will trigger a reward. Conversely, when funds are withheld as a punishment to a PHA for not taking certain steps, the public housing authority is then put in a position of having fewer resources and probably an even more difficult task in achieving the goals that it originally failed to meet. NAHRO believes that the most fitting reward for achieving certain kinds of management goals should be permitting the PHA to develop locally its own operating and management procedures with minimum supervision and restriction by HUD. This local flexibility can take the form of reduced HUD monitoring, relaxation of reporting requirements, and freedom for the PHA to operate and make decisions without constant supervision and review from HUD.

Thirdly, an obvious incentive that ought to be available to public housing authorities is not available. Here I refer to the absence of any realistic incentive to public housing authorities to increase tenant rental income revenue beyond what they have budgeted for. This is the case because, if PHA's do collect more rental income than is reflected in their budgets, the excess amount is subtracted from the following year's operating subsidy. On the other hand, if public housing authorities _do_ _not_ achieve their budget estimates for rental income, for any reason, by the end of the year, HUD does not make up the shortfall in any way. Budget shortfalls of this nature are particularly of concern to us during times of high unemployment when tenants' income does not rise. The lack of any incentive on the revenue side does not motivate public housing authorities to increase rental income by improving rental collections or maintaining higher occupancy levels than projected in their budgets. This is an area where NAHRO believes a direct financial incentive ought to be allowed which will result in immediate rewards to the public housing authority. What we are saying, Mr. Chairman, is that if PHA's achieve more tenant rental income than is reflected in their budgets through management improvements, they should be able to retain the excess with no offset to their operating subsidy. On the other hand, if PHA's do not achieve their budgeted income levels solely because tenant income does not rise as much as predicted, HUD should make up the shortage caused in the PHA's operating subsidy through no fault of the PHA. If we do this, we will reward public housing authorities which genuinely improve their management practices, and we will not punish those PHA's that experience revenue shortfalls for reasons beyond their control.

Other management incentives that we believe should be implemented include amending the three-year "rolling base" system to a five-year "rolling base." This would extend the period over which the public housing authority and HUD would share in any consumption reductions and, therefore, would increase the incentive to conserve and undertake energy saving improvements.

Lastly, Mr. Chairman, let me comment on the question of operating reserves for public housing authorities. These reserves are part of the PHA's cash-management plan are used to cover extraordinary or immediate short-term costs that are not anticipated in the budget. HUD has established a maximum and a minimum reserve level. If reserves fall below the minimum, HUD is not obligated to provide operating subsidy to bring reserves up to the minimum level. On the other hand, maximum reserves level defined as a percentage of public housing authorities' operating budget have very different implications for public housing authorities, depending upon factors such as size of their operating budgets and the condition of their stock. PHA's that determine that their local circumstances require them to have reserves in excess of the current maximum of 50% of their operating budgets should be allowed to do so at their discretion.

The foregoing are some of the NAHRO proposals which, we believe, if incorporated into the Performance Funding System, would go a long way toward improving the fairness and efficiency of that system.

Turning to an examination of the Administration's proposals for changing the way PHA's are funded, let me comment briefly on the Comprehensive Improvement Assistance Program. NAHRO is very concerned about the direction HUD has been taking toward de-emphasizing the comprehensive nature of the CIAP. HUD has stated its intention to issue regulations which would reduce the modernization standards used for CIAP to a level of minimum occupancy standards in an attempt to reduce the cost of modernization. While NAHRO agrees that health and safety improvements as well as energy saving aspects of a modernization program ought to receive some priority, we do not agree that giving sole and exclusive funding priority to these categories of improvements is in accord with the intent of Congress when it fashioned the CIAP as a comprehensive program to bring all housing units up to quality standards related to long-term usefulness. It is possible to accord these elements some priority without destroying the comprehensive nature of the program.

The comprehensive improvement assistance program is a well-conceived and well-designed program, Congressionally mandated with the clear goal of preserving and continuing maximum use of the existing public housing stock. We certainly hope that Congress will stick to its commitment to comprehensive modernization through a separate and adequate appropriation. We hope you will not accept either the Administration's attempt to change the comprehensive nature of the program through regulation or its attempt to do away with the program altogether by combining necessary capital improvement funds and operating funds in one subsidy allocation.

Mr. Chairman, the Administration has proposed changing the method of funding public housing operations and modernization by basing funding on a so-called "Fair Market Rent System." NAHRO believes that the proposed Fair Market Rent-based system bears no relationship to the operation of public housing projects. The operations of such projects should be funded on the basis of directly related public housing costs. The governing statute now clearly mandates a system based on the costs associated with managing public housing. The Performance Funding System is the system which has been fashioned by HUD through regulation to meet the statutory mandate. Now the Administration tells us it wants an entirely new system, one admittedly not based on the costs of operating public housing, written into law. We are told HUD will move by regulation to accomplish this end if legislation is not forthcoming.

The Administration proposes to replace the existing Performance Funding System with a system that uses private market rental levels for calculating the level of operating subsidy a public housing authority receives. As we understand it, the new system would limit the PHA's operating income (including a replacement allowance for future capital improvement needs) to an amount equal to the 40th percentile of Fair Market Rent of standard units in the area, less other public housing authority income including rental income and debt service reimbursement under an ACC. Also, the amount of operating subsidy available to a public housing authority under the Fair Market Rent-based system could not exceed the current level received under the

Performance Funding System, plus the replacement allowance. Moreover, in addition to covering all operating costs, PHA's would, after a four-year transition period, be required to finance any capital improvements from these limited revenues. Public housing authorities would no longer have access to a separate modernization program such as the CIAP.

Mr. Chairman, the heart of NAHRO's opposition to the Administration's proposal is our profound conviction that operating public housing is not comparable to operating private market housing. Public housing has a disproportionate number of large families and consequently of large units. Public housing is a unique program with a special mission: it has a higher percentage of single heads of households and a large number of children per unit. Also, a significant amount of our public housing stock is deteriorating due to age and use. Looked at from the private side, the fact is that rents are only one of the many factors which make the private rental market work, when it does indeed work at all for low-income persons. Other factors include federal and state tax concessions to rental property owners, capital appreciation, and favorable tax treatment through capital gains. Public housing authorities are not affected by such factors. Rents alone do not make the private rental market work. Other factors, including supply and demand pressures, weigh heavily in the determination of market rents. Thus a Fair Market Rent approach is really not relevant to public housing. Even if one thought the FMR concept was relevant to public housing operations, one would be hard pressed to give serious consideration to a proposal that would initially peg the FMR to the 40th percentile, exclude recently constructed housing and recent movers, and give the Secretary discretion to lower the FMR without a rule-making or publication for comment.

Also, Mr. Chairman, the private rental housing market does not labor under the enormous burden of regulations that characterize the relationship between local PHA's and their federal partners. For example, the private sector does not have to deal with:

1. Lease and grievance procedures
2. Utility allowance determinations
3. Federal audits
4. Annual recertification of tenant eligibility
5. Tenant participation requirements
6. Illegal alien screening
7. Calculation of different rent levels for different income levels
8. Social services
9. Family characteristic reports
10. Security services
11. Funding tenant councils and community organizations
12. Federal applications and reports
13. HUD-mandated salaries and salary schedules

In summary, Mr. Chairman, there are three key factors which clearly distinguish the public housing authorities from private rental housing operators:

1. The level of services that must be provided to tenants by PHA's is greater than anything imagined by most private landlords.

2. The degree of regulation imposed on PHA's by the federal government has no counterpart in the private sector.

3. Valuable nonrental-income economic incentives available to the private landlord are not available to the PHA.

What public housing authorities need now is stability in their relations with their federal partner and a maximum degree of flexibility in the management of their own operations. There is a great need to reduce rules and regulations which detract from the management capabilities of housing authorities and provide disincentives for sound management and increased revenues.

There is no need for a whole new arrangement for funding public housing operating subsidies, an arrangement which no one has proved will help better serve the housing needs of low-income persons.

From what we have seen of the development of this proposal, a HUD administered FMR system threatens to be less straightforward and more open to manipulation than the Performance Funding System. The only thing we know the new system would certainly produce is a period of transition which would no doubt be thoroughly chaotic and has the potential for traumatizing all of the participants.

If the Administration's primary goal is dollar savings, this should be made clear. NAHRO's primary goal is to provide adequate shelter for low-income persons in the most efficient and economical manner possible. There is no proof that the Administration's proposed new system will do this. In contrast, there is every reason to believe the present system can be improved in a manner that will accomplish this objective.

As you can see from the foregoing, Mr. Chairman, NAHRO does not believe that the Administration's proposed Fair Market Rent-based system for funding public housing operating subsidies has a great deal of merit. We do not believe that it is rooted in or reflects adequately the realities of public housing operations. We do not believe that it can be "fixed" with a little work around the edges. Rather, we believe it is fundamentally flawed.

NAHRO
Serving the Nation's Housing and Community Development Needs

3/1/83

NAHRO'S RECOMMENDED IMPROVEMENTS TO THE PERFORMANCE FUNDING SYSTEM

Developed by NAHRO's Task Force on the PFS
Preliminary Report

Introduction

This position paper consists of recommendations developed by NAHRO to improve the current Performance Funding System (PFS) which determines the distribution of operating subsidies to federally funded public housing authorities. NAHRO has long been concerned about the equity, adequacy, and efficiency of the PFS. These recommendations are specifically in response to those concerns and to the Administration's programmatic and systematic changes proposed for 1984. The Administration's 1984 HUD Budget Proposal calls for a major change in the public housing funding system based on an artificial, indeed fallacious, comparison between the costs of private housing and the costs of public housing, and the combination of capital and operating funds in one subsidy. NAHRO takes issue not only with the components of the proposed system (which will not be dealt with here), but with the degree of analysis and lack of public scrutiny the system was subject to before being fully and completely endorsed by HUD. While NAHRO recognizes that there are problems with the current PFS (delineated below), we believe that if the enclosed recommendations are accepted and implemented by HUD and PHAs, the improved PFS will be a more efficient and effective method to fund public housing operations.

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NAHRO has identified the following problems with the current system (not in order of priority):

- perpetuation of inequities in a PHA's base year
- extremely complex and burdensome to compute for HUD and PHAs
- underestimation of inflation with no year end reconciliation
- perpetuation of inequities in base factors resulting in bias against large urban PHAs
- lack of incentives for good management
- limited ability to respond to costs beyond control and/or extraordinary operating conditions
- disproportionate funding among PHAs
- funding not related to performance standards of individual PHAs
- lack of adequate and timely funding (timeliness not a direct problem of this system but of its recent implementation)

HUD has, in its Alternative Operating Subsidy Systems for the Public Housing Program, (Office of Policy Development and Research, May 1982,) developed a list of objections to the current system which is inclusive of the points above. NAHRO feels that where relief for these problems is forthcoming, HUD and PHAs can work together in fairness and mutual benefit to achieve efficient and effective management while exercising some control over the cost of providing decent, safe and sanitary housing to lower income Americans.

RECOMMENDATIONS

Formula Improvements:

1. Base Year/Allowable Expense Level Reviews

A PHA's Base Year Expense Level consists primarily of the PHA's non-utility allowable costs that were reflected in their approved budget at the time the PFS was implemented (1975). During PFS implementation, the PHAs' Base Year Expense Level was compared to other PHAs with similar characteristics which HUD designated as "well managed". The comparison was to determine if the Base Year Expense Level fell within a range of the prototype PHAs' costs. If it did not, a PHA was kept at its then current budget level until it eventually came within range. This base year level then became the PHAs' Allowable Expense Level (AEL). The AEL is updated annually to become the basis on which the determination of how much money the PHA receives in operating subsidy is made. Therefore, any inequities that existed among PHAs or any "fluke costs" that existed within a PHA in their base year that would skew a "normal" allowable expense level are simply compounded by this updating procedure. Additionally, this updating does not take into consideration changes in the types of costs that PHAs have incurred since their Base Year Expense Level; for example, the addition of social services or security services that result in increased costs for PHAs, but which are not part of their Base Year Expense Level.

NAHRO RECOMMENDS:

A formal review process should be instituted so that PHA can amend their current Allowable Expense Levels to correct for inequities and abnormalities in their base year and changes in operating-circumstances since their base year. Such a review process should be established on a revolving three (3) year cycle wherein thirty three percent (33%) of the PHAs are able to request review of their AEL in any given year - to begin 1984. Reviews would result in the correction of base factors - not in retrospective subsidy adjustments. PHAs should be allowed to have their AELs reviewed from their original Base Year in the initial years of the review process, 1984, 1985, and 1986; however subsequent reviews, beginning in 1987, should only relate to the previous three years. Parameters for the review process should be developed between HUD and PHA representatives. In the development of paramenters, consideration should be given to circumstances such as costs beyond control, mandated wage increases above the HUD annual inflation factor, the addition of projects, major changes in existing project profiles, changes in Federal, state and local laws, regulations causing major adjustments in management operating conditions, catastrophic events, etc. PHAs should not be allowed to request review of inflation factors because 1) the Retrospective Inflation Factor Adjustment that HUD and Congress supported corrected, to a large degree, any miscalculations of inflation prior to 1982, and 2) NAHRO recommends the adjustment of the inflation factor through ex-post facto reconciliation (if this recommendation is not adopted inflation factors should be subject to review). Finally, funding resulting from the review process should be part of the annual PFS operating subsidy appropriation and not a separately appropriated fund.

1a. AEL RECONCILIATION/SUBSIDY RECONCILIATION

The PFS is a "building block" or "roll over" type of funding system in that it uses last year's formula components updated by inflation factors (and to a much lesser degree factors related to change in operating circumstances). For this reason, accurate estimates from HUD regarding inflation factors are extremely important to PHAs in determining their operating subsidy. Inaccurate inflation estimates can negate any efforts the PHA has expended to "hedge" against inflation, particularly in times of rapidly escalating or uncertain inflation. Ironically, while inflation rates determine the increase (to a large degree) of subsidy from year to year, PHAs have no control over them; nor do they have any control over the inflation projections HUD makes when requesting subsidy from Congress.

Miscalculated inflation factors that are applied to a PHA's AEL to determine actual subsidy level have haunted both PHAs and HUD over the past few years. Underestimated inflation factors have resulted in short funding for most PHAs, which in turn has necessitated requesting supplemental appropriations from the Congress. The fact that Congress has responded favorably to supplemental requests in the recent past only lends credibility to the PHAs'contention of recurring underfunding. NAHRO feels that a vital improvement to the PFS is to develop a method to 1) end the systematic perpetuation of under and overfunding of PHAs due to incorrectly predicted local inflation rates, 2) end the subsidy inequities among PHAs resulting from incorrectly predicted inflation rates and 3) achieve both of these reconciliations without necessitating the enactment of supplemental appropriations.

NAHRO RECOMMENDS:

HUD should permit PHAs to make year end adjustments to their AELs to reconcile any differences between estimated and actual inflation rates applicable to the AEL. This process should be used to both increase AELs where inflation was underestimated and to decrease AELs where inflation was overestimated. This reconciliation will serve to update the AEL so that it is a more accurate base in the following fiscal year. The PFS should also provide for an adjustment in the amount of subsidy given to the PHA in the next year to compensate for the over or underfunding in the prior year.

2. "DELTA"

Delta is a factor designed to adjust allowable costs due to changes in PHA characteristics such as building age, building height, number of bedrooms per units, and SMSA population. Delta is extremely complex to derive and its ability to truly adjust for the aforementioned characteristics is questionable. The Alternative Operating Subsidy Systems for the Public Housing Program report acknowledges that historically Delta has been extremely small. These problems (particularly the complex derivation) outweigh the benefits of the particular "Delta" formulation. However, NAHRO feels that some increase in allowable expense levels should be factored into the operating subsidy formula to account for the aging of the stock.

NAHRO RECOMMENDS:

Eliminate the Delta calculation and replace it with a standard annual one half of one percent (.5%) increase to the Allowable Expense Level to account primarily for aging of the stock.

MANAGEMENT INCENTIVES:

Management incentives to provide better services, save money, encourage efficiency, motivation, and job satisfaction clearly do not exist in the PFS. Despite its name, the PFS provides disincentives to good management in some budget areas. It is not surprising that the lack of management incentives has been one of the greatest complaints about the system-coming from HUD, the Congress and indeed PHAs. This problem has been discussed for years; originally in the context of providing objective standards for PHAs to meet, and more recently, in terms of saving Federal dollars. What are effective and appropriate management incentives for PHAs and how can they be institutionalized?

NAHRO feels that incentives must be built into the PFS with two different (though not always separable) objectives in mind. One objective is to make more efficient the operation of the PHA, the other is to produce savings in operating subsidies for HUD. Achieving the first objective may not, or need not, produce financial benefits. Where appropriate, incentives should be designed to increase savings to the PHA to be used by the PHA for the improvement of the housing stock and/or tenant services, however NAHRO believes it is equally important to improve the living environment for tenants, provide better services while increasing the number of families served, promote staff motivation, pride and job satisfaction, etc.

1. Management Goals

Cost saving incentives which can be built into the PFS formula are detailed below. Before discussing the incentives NAHRO feels will motivate and allow PHAs to achieve the type of goals that can't be built into the formula but that are vital to the program, a look at how these goals should be defined is important. Before incentives can be of value, PHAs must be in agreement with HUD on the specific goals they are trying to achieve. All PHAs will not need to establish goals in the same management areas. NAHRO believes that management goals must be developed by looking at the particular management problems and conditions that exist in individual PHAs. A single national standard in different management areas is not applicable to PHAs because of regional, size and local variations. Rather, management goals for each PHA should be developed through negotiations between the PHA and the HUD Area Office. Some of this goal setting and problem identification may be accomplished through the development of the Comprehensive Improvement Assistance Program's (CIAP) five year plan.

Much thought by NAHRO, Congress, HUD and others has been given to the design of incentives to affect management improvements. Goals that can be built into the PFS formula typically carry the opportunity to receive additional funds as the incentive. NAHRO does not believe the granting of more or less operating subsidy for rewards or punishments is the most effective motivation to achieve all management goals. First, many management objectives are achieved in stages or increments, making it difficult for the PHA and the Area Office to be able to determine at which point in the achievement of the goal the PHA should be rewarded with additional operating subsidy. Also, when funds are withheld in an attempt to punish a PHA for not taking steps to achieve management goals, the PHA may then have an even more difficult time achieving the goals because of less resources available to it.

NAHRO believes that the most fitting rewards for achieving management goals should be the ability of the PHA to locally develop their own operating and management procedures with minimal supervision and restriction by HUD. Some of this local flexibility to develop procedures can appropriately be a function of reduced HUD monitoring, relaxation of reporting requirements, and the PHA's ability to operate and make decision without the Area Offices' constant input, supervision, and review.

NAHRO RECOMMENDS:

HUD and PHAs should develop a range of management areas to be used between PHAs and Area Offices to evaluate each PHA in the determination of management goals for that PHA. These management areas should include but not be limited to: vacancy rates, dwelling unit turn around time for reoccupancy, rent collection losses, accounts receivable, maintenance response time, accuracy and timely submission of HUD and PHA reports/budgets, energy conservation programs, contract administration, personnel policies and enforcement, inventory control, cash management/investment initiative, maintenance of adequate reserves, training and certification of staff, etc. PHAs should do an analysis of their management to determine which areas they are performing the poorest in. Then the Area Office and the PHA (and upon the the PHA's request, a third party), should draw up realistic goals in those management areas and a timetable for achieving them. NAHRO recommends that HUD publish a self assessment management guide to be used in this regard. Undertaking this self assessment should be funded by HUD (similar to the funding of performing energy audits for the CIAP).

If PHAs make progress toward achieving their goals they should be released from many of the burdensome reports and the constant monitoring by HUD that they currently operate under. PHAs that do not improve according to their goals and agreement with HUD should continue operating under the same constraints that they currently do. No additional strictures should be placed on them. Further consideration must be given to the treatment of PHAs who do not progress toward their goals for no fault of their own.

2. TENANT INCOME

The income side of the PFS has great potential for providing an incentive that can result in immediate financial benefit for the PHA. Surprisingly, the current PFS provides little or no incentive to PHAs to increase tenant rental income over what is budgeted for. This is because if PHAs do collect more rental income than is reflected in their budget, the excess amount is substracted from the following year's operating subsidy. In order to establish the budget estimate for rental income, the PHA applies a HUD mandated increase factor to their most recent rent roll (to date HUD has mandated that the budget estimate be a three percent increase over the most recent rent roll).
If PHAs do not achieve their budget estimate for income for any reason by the end of the year, HUD does not make up for the shortage in any way.

NAHRO believes the inability of the current system to make up subsidy to PHAs who have not achieved their budgeted income because tenants' income did not rise as much as they predicted is a serious problem with the system - particularly in times of volatile or high unemployment rates. Also, of concern is lack of incentives to increase rental income by improving rental collections and maintaining higher occupancy levels. While this concern is addressed to some degree through the achievement of management goals (discussed above), NAHRO believes that a financial incentive with immediate rewards is appropriate. PHAs that achieve greater occupancy, better rent collection, and other management improvements should be able to keep the over budget income resulting from these improvements.

NAHRO RECOMMENDS:

HUD should retain the current system of estimating tenant rental income on PHAs' budgets. Where PHAs are able to collect tenant rental income in excess of their budgets because tenant income rose at a greater rate than predicted, the excess should be offset against their following fiscal year. Conversely, if PHAs do not achieve their budget income levels because tenant income does not rise as much as predicted, HUD should reconcile the difference and make up the shortage in the PHA's following fiscal year's operating subsidy. If PHAs achieve more tenant rental income due to management improvements, they should be able to retain the entire excess with no offset to their operating subsidy. In subsequent years, HUD will experience savings in operating subsidy from these management improvements because a PHA's tenant rental income will be reflected in their budget at the higher level.

3. Other Income

PHAs experience the same dollar for dollar recapture by HUD (as in #1 above) for any non-rental income they receive that is not budgeted for. The PFS again provides a disincentive for applying for other federal funds, state funds, or city funds.

NAHRO RECOMMENDS:

Funds which PHAs receive to carry out activities which are not covered by their approved budget should not be considered an offset against PFS eligibility.

4. Rolling Base

The rolling base method of calculating the Allowable Utilities Consumption Level (AUCL) provides a great incentive to PHAs to reduce their utility consumption by allowing them to share with HUD savings resulting from reduced consumption. Recently HUD implemented a three year rolling base whereby PHAs would estimate their AUCL for their budget using the average utility consumption for the preceeding three years (rather than the utility consumption experienced during the Base Year.) Since nationally PHAs have conserved, the rolling base will produce a lower AUCL than the previous method of calculation would have. Since PHAs can retain one half of the savings attributable to below budget utility consumption levels, the rolling base provides great motivation to continue conserving.

NAHRO RECOMMENDS:

HUD should amend the 3 year rolling base system to become a five year rolling base system. This would extend the period over which the PHA shares in any consumption reductions and therefore would increase the incentive to conserve and undertake energy conserving improvements.

5. Operating Reserves

Operating reserves are the part of a PHA's cash management plan used to cover extraordinary or immediate costs that are not budgeted for. HUD has established both a minimum and a maximum reserve level, however, if reserves fall below the minimum, HUD is not obligated to provide operating subsidy to bring reserves up to the minimum level. Recently many PHAs have had to use their reserves to meet normal operating costs because funding from HUD has been either inadequate, very later in terms of their fiscal year, or both (in fact, many PHAs have completely depleted their reserves and there is no indication that HUD plans to restore minimum reserve levels nationally). PHAs must have the ability to build up and maintain adequate reserves. While HUD should support a minimum reserve level for all PHAs, the amount of reserves above the minimum necessary should be a local decision. Maximum reserve levels defined as a percentage of a PHAs operating budget have different implications for different PHAs depending on factors such as size of their operating budget and condition of their stock. For example, a very small PHA with a small operating budget and old stock may need to keep a reserve of greater than 40 percent of its operating budget to cover emergency costs. On the other hand, a very large PHA may not choose to keep a reserve level of 40 percent of its operating budget because that may be too great a dollar amount to keep outside of its normal cash flow.

NAHRO RECOMMENDS:

HUD should fund all PHAs' minimum reserve levels (which should continue to be defined as 20 percent of the PHA's operating budget) in addition to fully funding their operating costs through the improved PFS system. HUD should permit PHAs to add to their reserves at the PHA's discretion, over and above the HUD funded minimum.

Housing

Serving the Nation's Housing and Community Development Needs

March 28, 1983

The Honorable Jake Garn
Dirksen Senate Office Building
Room 5207
The Capitol
Washington, D.C. 20510

Dear Senator Garn:

The National Association of Housing and Redevelopment Officials (NAHRO) wishes to provide you with supplemental information to our recently submitted testimony on this year's housing and community development authorization bill. Specifically, we have additional information from the NAHRO membership which supports our position opposing the Administration's attempt to eliminate Sec. 104 of the existing Act, the lump sum drawdown provision.

In reauthorizing the CDBG program, we hope that you will retain this important provision. Our comments on the use of lump sum drawdown are attached.

We would be happy to assist you with any other information you might need.

Sincerely,

Robert W. Maffin
Executive Director

National Association of Housing and Redevelopment Officials
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CDBG - Section 104(g) "Lump sum drawdown provision"

Background: The original CDBG application and reporting requirements were amended in 1977 to require HUD to permit on a case-by-case basis, the lump sum drawdown of amounts designated in a CDBG application for the establishment in a private lending institution of a revolving loan fund to finance rehabilitation activities. This activity was never expressly ineligible but had been subject to differing interpretations by HUD area offices and was opposed by the Treasury Department.

The 1981 Omnibus Reconciliation Act, which eliminated the application requirements of the CDBG program, also eliminated provisions under Sec. 104(g) which required HUD to review and approve all agreements with lending institutions on a case-by-case basis. HUD also was required to determine whether each agreement met the minimum benefit standards prescribed by statute.

The 1983 amendments proposed by HUD ask for a repeal of Section 104(g). The department's primary justification for repeal is that Sec. 104(g) is the only provision among block grant programs that allow funds to be drawndown before commitment. Furthermore, HUD finds that even though, by statute, use of the deposited funds must begin within 45 days, there is no limit on when all of the deposited funds must be used.

HUD's second line of reasoning is that lump sum drawdowns are not necessary to achieve private participation in order to leverage funds. They allege evidence of about 200 programs (out of over 700) which involve significant private lending without the lump sum agreements.

Furthermore, HUD estimates that actual drawdown amounts under this provision from 1976* through 1981 are estimated to total between $300 - 400 million. The federal government is thus "forced" to "borrow" funds at high rates of interest long before their actual commitment to eligible projects. According to HUD, eliminating this feature could potentially save the federal government millions of dollars in interest.

Local experience: A number of localities have provided NAHRO with information on their experience with the lump sum drawdown provision. A substantial number of benefits are attributed to the use of the drawdown/deposit arrangements. Among these benefits are the following:

1. Increased participation/familiarity between public and private sectors. The benefits of this relationship are far reaching. Not only do local officials learn to have a greater understanding of each others needs and purposes, but the citizens learn how to deal with lending institutions and local governments become more responsive to needs of businesses. (Kenosha, Wisconsin)

*Amendment officially allowing the use of the drawdown/deposit was passed in 1977

2. Leveraged funds for increased rehabilitation. Regardless of initial leveraging ratios, deposits of CDBG funds into lending institutions are resulting in increased resources to meet local housing rehabilitation needs. Initial agreements with one lending institution promotes other such agreements with competing lenders. The increased interest and competition among lenders can only result in better deals for the cities. As cities themselves become more sophisticated financially, they are able to extract a higher ratio of private funds. (San Diego, Calif.)

3. Benefits to low and moderate income persons and those projects otherwise unable to be rehabbed. Banks normal maximum term for rehabilitation loans would be seven years. Because of the benefits obtained from an initial deposit (interest-bearing) with the bank, the bank makes loans available for up to twenty years. This extension is critical when dealing with substantial rehabilitation costs and lower income applicants. (Akron, Ohio)

4. Immediate working capital. One of the most troublesome problems in local rehabilitation programs has been contractor participation. Most contractors can not afford to carry expenses until a city receives money from HUD and the city's own accounting process. Payments from lump sum drawdowns speed-up the system considerably. A city can make payments within three days of inspections. This system provides localities with more control and has increased significantly the number of contractors who are participating. More contractors are able and willing to participate because payments can be made much quicker and easier. (Pittsburgh, PA)

NAHRO recommendation: Local experience is admittedly varied in regards to successful use of lump sum drawdown. However, many agencies have used the provision effectively. Were it not for the lump sum drawdown procedures many valuable and useful housing programs would not have been implemented.

NAHRO recommends that clear standards on the use of the lump sum drawdown should be developed by HUD. In the event a program does not meet these standards, interest income should be returned to HUD and the locality should be barred from participating. Suspension of a locality's participation should be continued until it satisfies the department's criteria. Department criteria should be expanded to include : 1) past performance,2) favorable rates of return on investment,3) time limits on use of lump sum deposit agreed upon between cities, HUD and private sector.

NAHRO thinks it would be shortsighted to see the lump sum drawdown as simply a drain on the Treasury. It is a unanimous feeling among our members that benefits derived from proper use of lump sum drawdown agreements should not be lost because of instances of abuse. We are supportive of regulatory changes which can correct inefficiencies of some local agreements and would be willing to work with HUD to improve upon its existing regulations.

Senator TOWER. Mr. Spence.

LEWIS H. SPENCE, DIRECTOR, BOSTON PUBLIC HOUSING AUTHORITY, BOSTON, MASS.; REPRESENTING COUNCIL OF LARGE PUBLIC HOUSING AUTHORITIES

Mr. SPENCE. Thank you, Senator. We've submitted testimony of the Council of Large Public Housing Authorities, so I'd like to summarize that testimony rather than reading it.

FMR ISSUES AND PROPOSALS

Briefly, I want to concentrate on the FMR issues and some proposals for alternative approaches and then mention very briefly three or four other issues that I think it's important that this committee consider with respect to the Fair Market Rent System, also known as the Federally Mandated Rent System.

Let me just say there are three areas where it seems to us that the FMR system is fundamentally flawed. It is first of all flawed in theory. It's flawed in theory because in fact the public housing program was conceived to fill the gaps that private markets couldn't meet.

Unfortunately, what the FMR theory suggests is instead that Federal investment in public housing track rather closely private investment. What this means, for example, is that in Philadephia where presumably low market rents have led to the abandonment of 40,000 units of housing in the last few years, there's substantial risk that an FMR system would say, "Where there's private disinvestment, so also should the Federal Goverment disinvest."

It seems to me precisely the opposite should be true. This is the counterbalance—this program must be the counterbalance to the vagaries and problems of private market housing, particularly with respect to low-income people.

The theory then seems to me fundamentally flawed. With respect to its administration, the FMR system would also be subject to enormous risk of manipulation. I believe and take as truthful and candid Mr. Abrams' statements—Secretary Abrams' statement that the administration and HUD is not looking to use this system to simply be a cost cutting device. Unfortunately, I think OMB clearly is. HUD came up with the proposal first, looking at 50 percent of recent moves as the way of determining a fair market rent level. It produced a 70-percent increase in the total operating subsidy for public housing, and that clearly was unacceptable to OMB.

The result is that the whole system has been enormously manipulated so that we're now down to 40 percent of all rentals to establish what the FMR would be. Clearly as a cost-containing measure mandated by OMB—the result I think is devastating for authorities and it opens up the possibility of annual manipulations as OMB each year says, "Wait a minute. In order to balance the budget on the backs of the public housing this year we have to make it 30 percent of all rents, or 45 percent of recent moves."

It's endlessly manipulable, and that seems to me a very substantial danger in an industry that desperately needs stability to be able to function.

The third and major flaw, it seems to me, in this is the complexity of the system as it's evolved. That complexity derives from the OMB demands for cost cutting, and what we have is not an FMR system but an FMR system on top of a PFS system.

What we have is something that says, "If you would get more under the FMR's, whose purpose was to simplify, then you have to go back and calculate what you can get under PFS, which is the system we already have, compare the two, and then you get the lower of the two."

That seems to me to have made hopelessly complex what was intended to be a simplifying mechanism driven, I think, by cost-containment concerns.

Finally, let me just mention its devastating actual impact. The impact of this program is, I think, obscured by the mix of two things: one, we're talking about operating costs; two, we're talking about capital investment. The replacement reserve notion is an attempt to add capital investments to the regular stream of income of local housing authorities, to the extent that authorities receive more. That is the combination of replacement reserves plus normal operating costs.

The actual impact on local authorities—and let me just give you some examples: Baltimore. For all authorities there's a scaled-down process. You can't lose more than 5 percent a year, but for the great majority of authorities, you will be scaled down over a period of years.

The bottom end of that process for Baltimore is a 35.6-percent reduction in dollars submitted to public housing in Baltimore.

Boston: 38.6-percent reduction in dollars going to Boston's public housing. Harrisburg, Pa.: 35-percent reduction in dollars going to public housing. Houston: 26-percent reduction. Jersey City: a 62-percent reduction. Mobile, Ala.: a 28-percent reduction. New York City: a 34-percent reduction. Philadelphia, a 35-percent reduction.

As both Mr. Struyk and Mr. Maffin have pointed out, this is a program in which the pie is made much smaller and the result of course is disinvestment in public housing at a time when this becomes ever more a safety net for the poor.

We believe that there are very positive alternatives, and I share with Mr. Maffin and Mr. Struyk their recommendations with respect to changes in the performance funding system, the adjustments in the inflation rate, the ex-post facto adjustments, some kind of an appeals process, and other such changes that are listed both in my testimony and that of others.

We do believe that these kinds of management incentives can provide improvement in the public housing program and in the management of public housing, both changes in the PFS and the addition of strengthened incentives in the area of rent collection, vacancies and the like, and improved performance in local housing authorities across the Nation.

But I would have to be candid. I don't think there's such a thing as a distribution system that assures in any industry that every institution will function well. There are variations in the quality of school systems and the quality of hospitals, and the quality of educational institutions.

In every industry we see good and bad. The problem is to provide an allocation system that encourages sound performance and then define ways to intervene to deal with destructive or failed performance.

We would propose—and we have been discussing this in the Council of Large Housing Authorities for some time—ways to do that. We have a general consensus on the notion that peer review and industry-developed standard approach—just as the health industry has done it, just as higher education has done it, and other such industries—is an approach that makes a great deal of sense. There are existing laws out there we can draw from.

The kind of thing we're thinking, and I can't speak for all of our organizations on this because it's still an issue under discussion, but the kind of thing we're thinking about is something like an accreditation process: a 5-year accreditation with reviews made up of experts in the field of public housing, a peer review kind of process to determine if the local housing authorities should receive a renewed accreditation for a 5-year period to determine the authorities that are weak, seek and provide peer review and technical assistance to strengthen them, and if they still fail, then to provide a basis under which an authority would lose its accreditation, and HUD might then intervene strongly.

That kind of process is the kind of process we're thinking about. We would urge that this committee give serious consideration to if HUD can be directed to support the industry in the develoment of industry standards and a per review process to enforce those industry standards.

I think that would be an enormously valuable contribution to the maturing of this industry and to making of public housing a sound and solid program across the Nation.

Finally, if I could, let me mention very quickly a couple of minor issues in some senses, minor compared to the issues we were discussing with respect to the future of public housing, but I think critically important.

Fair market rent levels for the section 8 existing program. These have remained steady since 1981. Housing authorities across the country are beginning to have increasing difficulty making the section 8 existing program work. HUD is proposing to further essentially reduce those fair market rent levels by the adoption of this 40 percent as opposed to 50 percent standard, and changing the base.

The result, we believe, of that will be this coming year three things: one, the section 8 existing program will have many more failures in it, many more low-income people unable to find housing in the private market, even with the assistance of section 8 existing subsidies.

Two, the quality of housing that those who do find housing will find will diminish; and three, the racial and economic segregation of those low-income persons will increase and rather than being a program, as it was initially intended, to reduce racially and economically impacted areas, that production method will have exactly the opposite effect. It will increase the incidence of both economic and racial concentration in ways that I believe will be destructive to housing markets and to our national well-being overall.

I hope that this committee and HUD will give real attention to that.

Second, we're concerned about potential delays in the distribution of fiscal year 1983 modernization jobs stimulus funds. The administration has been considering and is proposing a change in midcourse in those regulations. I think that may be under review by the administration. I hope the administration will not make those midcourse changes, particularly with respect to housing quality standards, so that that money can move out fast and we can work together with HUD to move those dollars quickly.

Finally, we would like to emphasize the issues of special problems in public housing development, and urge the committee to give to local housing authorities the discretion to reprogram existing development dollars, either for alternative development programs or for modernization and improvements in all housing authorities.

So those additional, less critical, but nonetheless important points I did want to touch on.

Thank you for your time.

[The complete statement follows:]

Testimony of Lewis H. Spence, Court-Appointed Receiver of the Boston Housing Authority, on behalf of the Council of Large Public Housing Authorities (CLPHA)

Mr. Chairman, my name is Harry Spence and I am the court-appointed receiver of the Boston Housing Authority. I am speaking today on behalf of the Council of Large Public Housing Authorities (CLPHA). CLPHA was organized in 1981 and now includes 31 Public Housing Authorities (PHAs) as members. These Authorities taken together manage approximately 30% of the federally-assisted conventional public housing program.

I would like to thank you and the staff of the committee for the opportunity to be here today. This committee has consistently taken a deep interest in, and shown strong support for, the public housing program in the past. We were happy to have had the opportunity on January 21 to make a presentation to committee staff on CLPHA's views concerning HUD's proposed Fair Market Rent system for funding public housing operating subsidies and modernization programs. Since that meeting, committee staff have been in touch with the Council regularly, and have strongly encouraged us to develop and present our own views on what kinds of improvements we think could be made to the existing public housing system. I would like to present these recommendations to the committee today.

I therefore would like to spend most of my allotted time talking about the "Fair Market Rent" system which HUD is proposing to use for funding public housing beginning in federal FY84; and the Council's alternatives, which include substantial improvements to the current Performance Funding System as well as a new system of industry-approved performance standards and a program of peer group assistance.

At the conclusion of my remarks, I would also like to comment on HUD's proposed changes in the Fair Market Rent levels for the Section 8 "existing" program; the delays that are being caused in this year's modernization program by HUD's mid-year efforts to change the rules; the Council's requested funding levels for public housing programs in FY84; and a special appeal to allow local Public Housing Authorities to re-program development funds which have been committed to the Authorities but which have been unusable through no fault of the Authorities themselves.

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1. Funding System for Public Housing Operating Subsidies and Modernization.

Mr. Chairman, normally we come before your committee each year to testify about our estimates of the funding requirements for public housing, and any "mid-course corrections" that might be needed to change or improve the program. This year, however, we have before us a proposal from HUD that goes to the very heart of public housing. This proposal has been called a "Fair Market Rent" system by HUD, but someone has more aptly named it the "Federally Mandated Rent" system.

The justification behind these proposals combines a mixture of bad housing economics with a morality play. Originally, HUD's posture was that public housing shouldn't cost more than private market housing to run, period. More recently, HUD has taken the position that the reason for the FMR system is that HUD should not have to pay more to subsidize a low-income household in public housing than the least-expensive alternative, namely a housing "voucher" or "modified Section 8 certificate." Under this new rationale, the actual costs of operating public housing and providing associated services is ignored in favor of a system whose primary objective is "cost-containment."

We have had the opportunity to present our objections to the FMR extensively on a prior occasion. I would like to summarize these arguments in the next few minutes.

a) Theory. First, the theory behind the proposed Fair Market Rent System is supported neither by research nor by common sense. There is no convincing evidence that public housing is comparable to the private market housing whose rents HUD would use as the standard under the new system. The real situation is just the opposite: public housing was designed to serve exactly those households whose needs were not being adequately served in the private market. Public housing involves costs and services which the private market does not provide.

In many of our nation's cities, and especially in the central cities which, as the U.S. Census of 1980 showed, are becoming increasingly the locus of greater concentrations of low-income families, market rents are not adequate now to sustain good quality rental housing in the private market, except in certain cases in the luxury sector. In Philadelphia alone, over 40,000 landlords have abandoned their properties over the last decade. When the private market can't make money at market rents, it gets out of the business. Pegging public housing costs to private market rents threatens to reproduce the same conditions in the public housing sector. But the public housing program has a mandate from Congress exactly not to abandon the difficult task of providing low-income housing.

Another illustration of the theoretical problems with FMR is that swings in the private rental market in an area will produce changes in public housing revenues that are arbitrary and completely unrelated to the costs of the Authority or the tasks it is responsible for accomplishing. The current funding structure for public housing was intended to provide a reliable cost-based system and avoid these arbitrary swings in the housing market.

b) Inadequate data and analysis presents problems in establishing reasonable Fair Market Rent levels. In spite of the extensive analysis and data-gathering efforts that have been carried out by HUD in evaluating potential alternatives to the present Performance Funding System, there is still no convincing data that indicates what would be a real and "fair" level at which Fair Market Rent levels should be set, how these figures would be developed, and how the other factors in the formula would be determined.

One of the options evaluated was to set the standard at the middle (median, 50th percentile) of the private market rent distribution. HUD's current proposal sets the standard at considerably below the middle (at the 40th percentile), which means that most rent levels would be at only 75-80% of the average for the area. The principal justification presented by HUD appears to be that the lower level would cost the federal government less. Certainly, no relationship has been drawn to housing authority costs, in making this distinction.

The FMR system also assumes that one average rent level can be developed that will apply to all PHAs in a metropolitan area. All studies of public housing, however, have shown that the per unit costs of operating and managing public housing varies by Authority size. Unlike stretch socks, "one size does not fit all." While HUD's proposed formula would vary the subsidy by bedroom size, and may allow a special adjustment for high-rise buildings, the Council does not believe that these "adjustments" are nearly adequate to reflect the differential costs of doing business that are experienced by Authorities in the real world.

Another problem is that the private market housing which HUD would use to establish the standards is generally not structurally comparable to public housing in the same areas. In many regions, a substantial proportion of the rental stock consists of one- or two-unit housing structures, not high-rise elevator buildings. The condition of these units is also often superior to the condition of public housing units.

In addition, there are a number of problems involved in using the available census data for establishing standards. The Annual Housing Census is taken only for certain metropolitan areas of the country, at intervals as long as seven years apart. In other regions and between years, estimates would be necessary. The definition of which units to include for comparison purposes also presents many unresolved problems.

c) Complexity introduced by cost-containment requirements. As I have tried to clarify above, Mr. Chairman, there would be serious problems in developing a Fair Market Rent system even if the objective were to be as fair as possible to the Authorities. Even beyond this, however, the task has been made impossibly complex by HUD's additional and over-riding objective of reducing over-all federal housing subsidy costs.

HUD's own studies of the costs of a Fair Market Rent system, using the 50th percentile (median) standard, showed that the total costs of the new system could equal over 70% more than the current Performance Funding System. As a result of this evidence, HUD has put such a severe "cap" on the new subsidy levels, based upon limiting the increase PHAs would get from the current system, that it is now estimated that 91% of the Authorities would get a subsidy under FMR that was actually based on the old PFS formula. These numbers would continue to determine the subsidy received by these PHAs in the future, adjusted only by an annual inflation factor. This is a stunning indictment of the failure of HUD to come up with a Fair Market Rent system that works.

Other complexities have been introduced by HUD to meet its cost-containment requirements. A replacement allowance was designed to be equal to 25% of the Authority's old "allowable expense level" (AEL). Even this was substantially lower than the funds most PHAs could expect to receive annually under the existing Comprehensive Improvements Assistance Program (CIAP) for modernization. Apparently this option was still too expensive, however, and has now been further cut to equal only 20% of the old "AEL." There has been no adequate justification by HUD of either formula.

In summary, Mr. Chairman, I would like to repeat our arguments in opposition to the proposed Fair Market Rent system:

- it is poor in theory, and relies upon faulty comparisons between public housing and private sector housing;
- the system is too easily manipulable -- there has been a lack of data and analysis that would provide anything like fair or objective standards for determining the amount of subsidy needed by Authorities; and
- the system has become exceedingly complex, resulting from HUD's and OMB's goal being cost containment irrespective of the impact upon sound housing management.

2. Improvements in the Current System Proposed by CLPHA.

In contrast to the radical changes being proposed by HUD in the way that operating subsidies and modernization are funded, the Council has developed a number of sound, substantial proposals which we believe can work and will improve the quality of public housing management.

a) Technical improvements to PFS.

The first of these relates to the annual inflation rate for the non-utility line item. These rates are projected far in advance for all PHAs by HUD in Washington, D.C. We propose that there be an "ex post" adjustment to these rates made in a way comparable to the adjustment factors HUD now uses for the utility line item, to allow for real inflation rates as opposed to those projected long before the beginning of the PHAs' fiscal years.

The second is that HUD should allow PHAs to use a five-year rolling base for budgeting their utility costs, excluding the year immediately preceding the budget year. HUD currently allows a three-year rolling base. Extending the period to five years allows PHAs to recapture savings from energy conservation over a period more likely to be comparable to the payback period for the original energy conservation investments, and thus encourages more such investments.

A third is establish a carefully controlled appeals process that would give HUD a procedure to deal with PHAs with special problems that cannot adequately be handled under the existing formula. The amount of funding that could be released through the appeals mechanism, and the number of times a PHA could use this mechanism during any given period of time would be limited.

Fourth, the method of calculating the change in the per unit subsidy used to reflect the changing operating circumstances of the Housing Authority (the "Delta" factor) should be simplified.

Fifth, a review should be undertaken as to whether or not the PFS base-year figures adequately reflect the current 1983 cost differentials of PHAs with regard to family size. The Council believes that the cost of housing large families is growing as a ratio to smaller families and elderly households, and that widening differential needs to be reflected in a formula adjustment.

b) Management incentives.

One of our major concerns is that when PHAs make a special effort to gain outside sources of funds to supplement PHA revenues and operating subsidies, these not automatically be deducted from the federal operating subsidy. We would like to encourage Housing Authorities to go after CDBG funds, Low Income Energy Assistance Funds, private foundation money, and oil company overcharge rebates, just as examples. In some of these cases, a partial deduction may be justified. I would like to point out, however, that in each case the application for these funds by the PHA requires time, energy, staff and money. Any PHA will be reluctant to invest its limited funds and technical and legal staff resources in these applications if all of the resulting funds are to be deducted from operating subsidy. We would therefore like to call upon HUD to review its policies in these areas to provide greater PHA incentives to applying for outside funds.

In addition, the Council believes that HUD could develop some specific management incentives for good PHA performance in managing the properties. One example would be to allow PHAs to keep some proportion, say 50%, of the increased revenues resulting from increased occupancy rates, for a period of at least three years. In the private market, the lack of such incentives often leads to the abandonment of private market housing properties. The same principal could be applied to reducing arrearages in rents in public housing. These kinds of measures, if carefully limited, would not result in "slush funds," surpluses, or increased operating reserves for Public Housing Authorities. Rather, they would simply pay back the Authority for the costs incurred in making the necessary management improvements. This is the kind of payback which is widely recognized as being effective in the private sector.

c) Establishment of rent levels. In terms of rent levels, the Council continues to support a return to the 25% rent-income-ratio, or at the minimum a freeze at the current 27% level. The Council also supports maintaining deductions for households with working people in them. Most of these deductions would be eliminated in HUD's new regulations (for example, child care deductions and deductions for travel to work). We believe it is essential to continue to provide fair treatment to working households in order to enable them to be an important part of the public housing community at the local level. We also support giving PHAs the option of instituting ceiling rents for a limited proportion of their units, provided that these ceiling rents would be no lower than some fixed proportion of comparable private market rents.

3. Industry-Approved Performance Standards with Peer Group Assistance.

When the original Performance Funding System was put into place in the mid-1970's, it was envisioned that eventually a set of performance standards would be developed to accompany the system. Due to the great variety in local PHA circumstances and conditions, as well as the problems associated with developing fair and adequate performance measures, this task has never been carried out. The Council believes, however, that the time has now come for tackling this problem through a system of industry-approved performance standards with peer group technical assistance.

The questions one can always ask about such standards include:

- who will set the standards, and how?
- what will the standards be?
- how will they be used, and by whom?
- what will happen to those who fail to meet the standards?

The setting of standards should always be looked at in the context of how they will be used, and whether or not they will do any good. Clearly, Housing Authorities do not like the idea of an oversimplified system in which simplistic standards are adopted uniformly on a nationwide basis, and then penalties are applied to PHAs that do not meet these standards. This approach seems unlikely to reform troubled PHAs. On the contrary, there is every reason to believe that such an approach would instead result in a reduction in subsidies to those PHAs which are the most troubled (and in the most need), with a consequent reduction in management's ability to deal with those very problems.

Although the Council has not adopted a final position on these issues as a group, I would like to present today the kind of thinking that we have done about how to address problems of performance and how to provide means of intervention where there is poor performance. There are clearly a variety of PHAs, both good performers and bad, and remedies are needed where incentives fail.

Instead of adopting a system of penalties, however, CLPHA proposes that HUD be mandated by Congress to work with the public housing industry to develop industry-approved standards, reflecting the individual circumstances of each PHA. The appropriate industry groups which would be involved in this process would include the major actors such as the Council (CLPHA), NAHRO and PHADA. There are already-existing models in both the education and hospital fields that could be used to establish such a process of developing standards.

The Council believes that it is most important to develop these standards for the largest PHAs, for example the largest 150 which manage approximately two thirds of all the conventional public housing units in the nation. A review process for these PHAs could involve reviewing 30 Authorities per year, on a five-year cycle, a managable process. The object of the reviews would be to determine whether or not the PHAs deserved an accreditation rating, again based on models in the education and hospital fields. One of the results of the reviews would be, for troubled PHAs, to lay out a set of limited, accomplishable goals that would be within reach of the Housing Authority within the next few years.

The Housing Authority industry associations would simultaneously establish a system of peer group technical assistance. Housing Authorities with special problems could voluntarily request help from this technical assistance pool, in order to meet the goals that had been established and regain full accreditation.

In the case of Authorities that failed to improve their operations as a result of this assistance, HUD intervention with consultant help would still be required, but only as a last resort.

I would like to briefly summarize five advantages of this peer group review, accreditation and technical assistance process:

- it would encourage the development of professionalism in the field;
- it would encourage self-help and communication, and cross-fertilization of ideas among housing authorities;
- it would help to insulate judgements concerning housing authority performance from the vagueries of changing directions under a series of national administrations;
- it would provide for review of performance by those most knowledgable about the problems and methods of administering public housing;
- models for this type of process already exist in other industries, and a system for public housing could be developed in conformance to established practices in other industries, rather than inventing a totally new system "de novo."

This concludes my remarks concerning the Fair Market Rent system, an improved Performance Funding System, management incentives, and a new peer group review, accreditation and technical assistance process.

I would now like to turn to a few other matters of concern to public housing authorities which are before this committee.

4. Fair Market Rent Levels for the Section 8 "Existing" Program.

Fair Market Rent levels have been frozen since March 1981 for the Section 8 "existing" program, contrary to the intent of Congress that they be reviewed and adjusted annually. Furthermore, HUD is now proposing that these levels be dropped from the 50th percentile of recent movers to the 40th percentile of all units excluding recently built units. The Council believes that this new regulation, if adopted, would severel compromise the ability of the Section 8 "existing" program, one of our most successful housing programs, to do the job.

Recent surveys by CLPHA, which have been distributed to the committee's staff, show that Section 8 "existing" success rates have already begun to decline due to the freeze on Fair Market Rents, and landlords have begun dropping out of the program. This experience should be weighed carefully by the committee, and we would like to ask that HUD's proposed regulations changes be disapproved.

5. Prompt Approvals for FY83 Modernization Jobs Stimulus Funds.

Congress has approved $2.5 billion for a modernization/ jobs stimulus package for FY83. CLPHA made a presentation to HUD at the end of January commending the Department for moving up its pre-application date to February 11, and recommending ways for HUD to expedite the process of releasing the funds, getting them to work, and getting people employed within the quickest possible time. In general, we believe that these recommendations were well-received by HUD. However, there now appears to be a danger that new HUD-proposed mid-year changes in the modernization regulations will seriously impede the release of funds this year. We are worried that the loss of millions of dollars of improvements hangs in the balance, since over a million dollars are lost to inflation for every week of delay. In general, in the past, HUD's modernization program has been effective and reasonably well administered. We support it, thank Congress for the money, and want to continue to work with Congress and HUD in order to get this money out into the field where it can do its job as intended, as quickly as possible.

6. CLPHA Requests for Funding Levels in the FY84 Budget.

a) For public housing development: 25,000 units (since one year was skipped).

b) For public housing operating subsidies under PFS: $1.58 billion.

c) For public housing modernization: $2.5 billion.

7. Special Problems of Public Housing Development.

We again would like to request that Congress urge HUD to move the funds for public housing development that are currently in the pipeline. We would note that HUD appears to be caught in the middle between Congress requiring the Department to move these funds and the White House and OMB urging further delays or recapture of the money.

Finally, we would like to ask that the FY84 funding levels listed below come out of new appropriations, but that PHAs ought to be able to use development funds that are currently unusable through no fault of their own for different purposes, for example for either a choice of other developments or for substantially rebuilding existing developments.

Senator **Tower**. Thank you, Mr. Spence, members of the panel.

Senator **D'Amato**. Thank you, Mr. Chairman, it's a pleasure to have our Assistant Secretary, Phil Abrams, before us. He labors in a very difficult area. However, he brings very great expertise and, more importantly, great energy and integrity to this position.

Mr. Abrams, it's good to see you.

FORMULATING FAIR MARKET RENT SCHEDULES

The Department is currently in the process, as you have indicated, of formulating its fair market rent schedules for 1983. I take it from your testimony that these regulations will have some profound effects on the existing section 8 program and would be the cornerstone in determining the level of operating subsidies for public housing authorities under the Department's new proposal for using the fair market rent system; is that not correct?

Mr. **Abrams**. Yes, sir.

Senator **D'Amato**. In calculating the fair market rents for New York City, I have been informed that HUD will be relying on rental cost data from 1976, the 1976 Annual Housing Survey.

It seems to me, No. 1, that there certainly is a lack of logic in going back to 1976—if, in fact, that's true; that there is more current data you could have utilized, which would be the 1981 survey, that in 1976 there were 650,000 units which were rent controlled in New York City. In 1981, less than half of those units were rent controlled. Thus, the rents have risen substantially for those units. Yet, these decontrolled units are not included in the data bank. Consequently, that will skew tremendously the operating subsidy base the section 8 fair market rent formula.

In addition, our fair market rents are currently set at the 50th percentile of rents encountered by recent movers as Mr. Spence and Mr. Struyk have testified. You're going to use the 40th percentile of all standard quality units, which includes public housing units; is that true?

Mr. **Abrams**. Yes, Senator, that's correct.

Senator **D'Amato**. OMB was really in there working, weren't they?

Mr. **Abrams**. This is not an OMB proposal, Senator.

Senator **D'Amato**. After they were done looking at your initial proposals, they must have said, "Go back to the drawing boards."

How can you use 1976 data that uses outmoded statistics, then utilize public housing units in which rents are substantially lower for the first time in calculating this formula, then utilize the 40th percentile instead of the 50th percentile, and believe that this is going to be a reasonable formula. Will not this new fair market rent system bring great devastation to public housing, not only in New York, but in Boston and in other major urban centers, wherever public housing prominent.

I suggest to you, Phil, that this is going to fly directly in the face of what should be attempting to accomplish.

As I see it you are going to have more public housing authorities not being able to survive and provide safe and decent housing to those truly needy.

I would ask you to comment on the use of these statistics.

Mr. **Abrams**. I'd rather respond to your opening remarks, Senator. [Laughter.]

But I appreciate both remarks.

I'll comment on the facts that you are questioning.

The 1976 annual housing survey, conducted between April 1976 and March 1977, is the most current SMSA survey for New York for which data are available. Another special survey of the New York SMSA was conducted in 1980, but the data from that survey have not been processed by the Census Bureau and could not be used for the 1983 fair market rents. We hope to be able to use the 1980 annual housing survey data next year.

The Department uses the annual housing survey to the maximum possible extent for determining fair market rents because it enables us to make sure we do not include the rents of substandard housing units. The decennial national census includes only information on whether housing units are without complete plumbing or private kitchens, and no information on whether there are other deficiencies that would cause the unit to fail the housing quality standards used in the section 8 existing and housing payment certificate programs.

The rents from the most recent annual housing survey are updated to the current year by using the rent and utilities components of the Consumer Price Index. This updating should pick up rent increases that have occurred in New York City as rents are decontrolled. In addition, the New York City Housing Authority has based its comments on the proposed fair market rents for 1983 on New York City's housing and vacancy survey for 1981, and the Department will take this information into account when publishing the final version of the 1983 fair market rents for New York.

I agree with you that when you base the principal means of subsidizing low-income families on a voucher, and you base the public housing operating subsidy system on that same existing fair market rent, it must be above dispute, it must be irreproachable, and it must be consistent and justifiable.

EVALUATING CHANGES

Now, in evaluating the changes to the fair market rent, we looked particularly at the data on the current standard of the 50th percentile and found that that data was inappropriate and resulted in rents being set, under the certificate program, which are in excess of what's being paid by the private sector in most communities.

The results are that every landlord who participates in the program—and I'm sure you'll understand that when HUD sets maximums they become minimums—all rents for families participating in the certificate program soon rise to the level that HUD publishes as the maximum fair market rent.

But I don't want to minimize your criticism, particularly as it applies to New York, because we have continued to evaluate, and we agree with you that changes are needed particularly the rents for large family units. One of the members of the committee yesterday pointed out to the Secretary, and accurately, that large families, whether they're minority families or nonminority families, have the most difficult experience in using the certificates. In fact, over 70 percent of these families have difficulty in finding a unit within the 60-day period.

Because of that, we are reevaluating the fair market rents, particularly for three-, four-, and five-bedroom units, because we want to induce the private sector to make them available under the certificate program, because we want to keep them in the public housing stock, because they are necessary to take care of the families that are in the greatest need of assistance from HUD.

We are looking at the current formula. And again, the data that we get from the annual housing survey gives us enough information to set the fair market rent for two-bedroom units. And we're confident that setting the two-bedroom units, as well as the one-bedroom and the efficiencies, at the 40th percentile of all apartments—is adequate to make the program work.

The rents for three-bedroom apartments have previously been set arbitrarily at 115 percent of the two-bedroom unit. The reason that's done arbitrarily is that the annual housing survey data in many markets show three-bedroom rents lower than two-bedroom rents, which may be an indication of something that Mr. Spence said, when we get to those units not being available to low-income families.

So, we now have concluded that the 115 percent may be inappropriate. And we are trying to come up with a percentage.

I would prefer to rely on annual housing survey data, real data. But I don't have good enough data unless we only look at those areas where the three-bedroom rents are higher than the two-bedroom rents, and discount as being anomalies any area where the three-bedroom rents are lower.

But whether it's that formulation or whether it is a greatly increased percentage difference between two bedrooms and three bedrooms, we are committed to making the system work.

As you accurately stated, the fair market rent is the cornerstone of both systems. And if it isn't credible, then nothing we're proposing is credible.

Senator D'AMATO. Phil, may I say that my first remarks, regarding your ability and openmindedness, still go unimpeached as proven by your response.

And I thank you for being candid, because many times there is a temptation to stick with a program where there are these basic problems.

I am heartened by your testimony, which indicates to me that you will keep an open mind and work with the authorities and with this committee in seeing to it that these obvious inequities will be addressed.

And I do means obvious. As I am sure you are aware when you deal in the area of public housing, there are many inherent differences between their operation and the operation of the private dwellings.

As has been testified to by a number of our panelists, there is virtually no multifamily housing construction taking place except in housing for the affluent. And we certainly can't use such rents as a criteria, as such units just don't have the same problems, for instance, larger family units occupied by families with many children; they are not located in the poorer areas, subject to neglect due to lack of capital and vandalism. Their operators aren't restricted in the discretion they may exercise in terms of choice tenants, in terms of eviction of troublesome tenants, as are the housing authorities.

And in spite of this, many public housing authorities such as that in New York City operate with a high degree of efficiency due to superb management.

Yet, under these formulas, which are admittedly somewhat soft, it is estimated that the New York City Housing Authority could lose up to $35 million, notwithstanding the of holding harmless factor for the first few years, $57 million for the second year, and $75 million for the third year when the city's historical levels of CIAP moneys received are accounted for.

So, I think that these are matters which you and I have touched on in our dialog and which have been testified to by our panelists are of great importance.

And I appreciate again, your assurance that we will be able to sit down with an open mind to deal with the obvious problems that have been exposed.

Mr. ABRAMS. Senator, as you know, the Secretary is very concerned about the problems of New York, as he lives there.

Senator D'AMATO. I live there, too.

Mr. ABRAMS. And we spend a considerable amount of time being concerned about New York.

I'm somewhat concerned about Boston. But we're concerned about 3,800 housing authorities as well.

With regard to your later comment on the level of funding under the proposed system, under the current system of PFS, New York would get $290 million. Under the proposed system, New York would get $334 million, which is an increase of $44 million over what they currently get.

That includes the 5-percent phasedown in the first year, and it doesn't include the transition modernization, a part of the $3.5 billion part that would be directed toward New York and the other housing authorities that would get reduced payments.

PUBLIC HOUSING VERSUS PRIVATE SECTOR HOUSING

With regard to comparisons between public housing and private sector housing, I think your comments, plus Mr. Maffin's comments, deserve some clarification.

The fact that there has been very little private, unassisted housing built for low-income families is true. But the fact is that during the early 1970's there were 4 million units converted from large residential properties to multiple residential properties, as well as conversions of commercial and industrial buildings.

In response to previous questions from a Member of the Senate, many of those units and many of those conversions have taken place by utilizing existing structures, particularly in cities that have had declining populations and have been directed particularly at low-income housing populations.

As far as the tax advantage of private housing and the tax incentives, public housing also has many tax advantages.

Senator D'AMATO. I think Mr. Maffin's suggestion and Mr. Spence's was that we find ourselves in a situation today where people are going in strictly for tax advantages, and there's little incentive over and above that.

I think it is irrefutable fact that construction of public housing, is the minimus.

We know what was taking place in the 1970's. But we are talking about today. And, more importantly we are talking about what is going to take place in 1983 and 1984.

And I commend you for working with us and developing realistic standards for rehabilitation. It makes a lot more sense to rehabilitate a building before building a new one.

But let me suggest to you that when you use the 40th percentile, using public housing units to be figured in in terms of rent schedules, you can be devastating to the public housing authorities throughout this country.

You heard the testimony of Mr. Spence, Mr. Struyk, Mr. Maffin—and I think they're accurate and correct.

The fact of the matter is that the New York City Housing Public Authority and the section 8 program would be damaged substantially if section 8 fair market rent schedules and the new fair market vent system for the calculation of operating subsidies were allowed to go into place under the current regulations that have been proposed.

I would think that that is not your nor the Secretary's intention, because I can attest to your concern and dedication in these matters as exemplified when I have come to you with our local concerns.

Thus, I am further heartened when you indicate that you would be willing to sit down and work out what I think are obvious glaring deficiencies.

And if they are allowed to go in as is, they will wreak considerable havoc on public housing authorities throughout this Nation. We do not need that.

Thank you, Mr. Chairman.

[Response to written questions to Mr. Abrams from Senator Tower follow:]

RESPONSE TO QUESTIONS OF SENATOR TOWER

Q. Am I correct that column 3, "Fair Market Rent Subsidy If No Transition" represents what an authority will get in 1988 when moderization funding ends?

Mr. ABRAMS:

A. No, column 3 is an estimate of the amount of operating subsidy which each PHA would receive in 1984 under the FMR formula, assuming there were no transition funds provided for PHAs that need to reduce operating cost levels. It does not represent the amount the PHA would receive in 1988 or any subsequent year; because of inflation, the FMR-based subsidy will rise with the year-to-year increase in private market rents.

Q. Where column 3 is smaller than column 1 (indicating a transition authority), which PHAs will get some part of the $3.5 billion in modernization funds which you will recommend over the next several years? What criteria will be used in determining that?

Mr. ABRAMS:

A. We expect to use the $3.5 billion in transition modernization budget authority to provide assistance to all of the "transition PHAs" -- those where the FMR-based subsidy would be less than the subsidy available to them under the PFS formula plus the replacement allowance. The exact criteria to be used in distributing these funds have not yet been determined; however, we expect that the amount received by each of these transition PHAs will depend on how much is needed to place all of their units in good operating condition and make them energy-efficient. Our objective is to help them reduce utility and maintenance costs so that they can function successfully under the new funding system.

Q. I understand that your directive to the Regional Offices has been to use the $2.5 billion which the Congress appropriated last year as a jobs stimulus to bring buildings up to Housing Quality Standards? And, is it correct that these standards yield more temporary and less durable improvements than you would get with a deeper, more extensive rehabilitation investment?

Mr. ABRAMS:

A. At one point, I had indicated to HUD's Field Offices my desire to use the Section 8 Existing Housing Quality Standards for the modernization of public housing, in order to maximize the ability of the Department to rehabilitate the public housing inventory. In so doing, it was always intended that all units modernized to the Housing Quality Standards would have long-term viability. However, I have decided not to pursue the use of HQS and have instructed the Field Offices to continue using the modernization standards which have been in use since the inception of the Comprehensive Improvement Assistance Program in Fiscal Year 1981.

In carrying out the Comprehensive Improvement Assistance Program, we recognize that rehabilitation activities can also be of great benefit in stimulating the production of jobs in the local economy. However, the 1983 modernization funds cannot realistically contribute to early job creation because of the time necessary to plan and design the rehabilitation programs and make funding decisions. Nevertheless, we are making every effort to get these public housing modernization projects underway and, more importantly, to move forward quickly with the $2 billion in modernization which has been obligated in earlier years but has not yet produced real jobs through rehabilitation activity.

Senator **Tower**. Gentlemen, thank you very much.

You've made valuable contributions to our record.

Senator Lautenberg would like to submit a question for the record for Mr. Maffin and Mr. Spence.

Would you be kind enough to respond to it.

You oppose this new system proposed by HUD which replaces rising year-to-year subsidies and is intended to appeal to the promise of stability and the leveling off of costs. The question is: If not this, then what? How can we make the system better in the interests of the investment we have made in the physical stock?

Mr. Maffin, would you comment, first.

And then, Mr. Spence, would you comment.

Mr. **Maffin**. Mr. Chairman, in our written testimony, we made some specific suggestions on how to improve the existing performance funding system.

We believe that with the kind of modernization program the Congress enacted 3 or 4 years ago, coupled with some revisions in the performance funding system, as we suggested in the written testimony, coupled with the kind of self-policing, self-analysis, whether it's accreditation or simply a matter of what's been going on for years, exchange of knowledge and experience, we believe the combination of those techniques will make the flattening out of the sharply rising performance-funding costs, the operating subsidy costs that have risen rather sharply over the last decade flatten out.

Part of those changes we believe have arisen because of changes in the law, to say the least. Part of the suggestions we are making will increase flexibility at the local level.

The situation we find ourselves in now is that the dollar-for-dollar exchange—for example, the performance-funding system now provides that if an authority is able to economize, if it's able to save money and improve operations, it, in fact, takes money out of the operating subsidy to which that authority is entitled under the regular formula system.

We believe that allowing those kinds of incentives over the short run, coupled with the modernization program, will bring about a flattening of the requirements for operating.

Senator **Tower**. Mr. Spence, would you comment?

Mr. **Spence**. Very quickly, if I could just mention two quick thoughts.

One, I am heartened by Mr. Abrams remarks with respect to large family units and the level of FMR's.

We share with you, Senator, the sense that Mr. Abrams is vigorous, intelligent, and honorable.

When we have been opponents and when we are able to escape the clutches of OMB sufficiently to work together, he is equally vigorous, energetic, honorable and intelligent in his work.

I'd like to add one other quick thing.

With respect to the New York City Housing Authority, I think the New York City Housing Authority stands tall, not only among public housing agencies, but among all public and private large-scale enterprises in the country.

It is exactly the kind of expertise and professional capacity that lies in New York and can be of enormous benefit to other authorities and that makes us believe that the kind of peer review industry standards notion and accreditation process makes a lot of sense.

The more all of us could benefit from that kind of cross-fertilization of ideas, the more encouragement there is to the industry to share in the kinds of things that New York has done so well and I think more valuable the process.

Finally, with respect to improvements, I think the PFS improvements we've talked about in the accreditation process, it's our view that some kind of peer review process with those improvements incentives can go a good ways, a long ways toward maturing this industry.

LOWER OPERATING SUBSIDIES

I share with Mr. Maffin the belief that you will see a leveling off of operating subsidies, certainly from the steep climbs you have seen in recent years. Those track almost exactly the increases in energy costs.

The BHA's request for operating subsidies for the coming fiscal year is lower than our request for operating subsidies for the year we are in right now.

And it's lower because of accomplishments in reduced energy consumption, lower energy costs. And those things together have actually lowered our operating subsidy requirement from what it is this year.

I think you'll see a leveling off in this, as in all other energy-dependent industries. And housing is an immensely energy-dependent industry.

So, I think there can be some reassurance for the Congress in that so long as oil prices continue to decline.

And I think that, coupled with stability in the system, sufficient stability, so that there's predictability—real estate is a long-term business, not a quick turnaround business—stability in the system, with consistent improvements and incentives to professionalization, I think can move this program further ahead in the years to come.

Senator D'AMATO. Mr. Chairman, I'm wondering if I might ask one further question.

If, Mr. Secretary, in your review with regard to rent schedules for larger units, it is determined that, indeed, there should be an adjustment necessitating expenditures of additional sums, the obvious question is will HUD be in a position to ask for those additional moneys to support that need. In other words will HUD fight the battle of the budget in the realization that housing and shelter are a necessity.

Mr. ABRAMS. Senator, I support the thrust of what you're saying. But I have two things in the back of my mind that I'll verbalize at this point.

First of all, as Mr. Spence pointed out—and I would return his comments about me by saying that we have been working closely with the Boston Housing Authority, as well as with the New York Housing Authority, because they do have superior management.

And as a native of Boston, public housing in that city, from what it was, probably the worst example in the country, to where Harry Spence has brought it, is one of the amazing stories of public housing which the media don't often dwell upon. But the Department certainly appreciates it, because he makes our job much easier.

As far as the costs, one of the factors that Mr. Spence pointed out is that energy costs have reduced. The decrease in oil prices, when contrasted with the inflation that was projected in the budget, shows that there is, at this point in the year, somewhere around $24 million in savings over and above the deferral that was requested by the Department in 1983 and a $33 million savings over our projections for 1984.

As oil prices continue to reduce, we note that for every 1-cent-a-gallon decrease in oil prices, the cost of the subsidy required for public housing goes down by almost $3 million.

So, we look toward that as being a source of funds, but again, we don't have the data to equate to what the costs will be for a higher fair market rent for the three-, four- and five-bedroom units.

But the Secretary is committed to making the system work, and we are well aware if we don't make the three-, four- and five-bedroom unit rents work, then we have a major flaw in our proposals. So, we will fight for that and keep you advised.

Senator D'AMATO. Thank you, Mr. Secretary.

Senator TOWER. Gentlemen, Mr. Abrams, Mr. Struyk, Mr. Maffin, Mr. Spence, we appreciate your giving your time and your energy and your intellect to the committee today. It's been extremely useful testimony, and it will assist us in our deliberations.

Thank you very much.

The hearing is adjourned.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

FISCAL YEAR 1984 HUD AUTHORIZATIONS

THURSDAY, MARCH 16, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 9:40 a.m., in room SD-538, Dirksen Senate Office Building, Senator John Tower presiding.

Present: Senators Tower, Hawkins, Trible, Proxmire, and Riegle.

OPENING STATEMENT OF SENATOR TOWER

Senator TOWER. The committee will come to order.

This morning we conclude the hearings on the administration's of fiscal year 1984 HUD authorization proposals. In the course of the hearing we will continue to explore the question of low-rental-income-housing availability versus affordability. This committee last year developed proposals which addressed both needs but limited development of new housing to instances of proven local need.

Our second panel will address these and other issues related to assisted housing. The first panel will address the secondary mortgage market, including proposals to amend the Charter Acts of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Some of the FNMA and FHLMC proposals are controversial and will require careful consideration. A number of organizations, including the National Association of Realtors, have expressed alarm at FNMA's request for additional asset powers to divert that institution from their primary mission of supporting the residential mortgage market.

In addition, we are witnessing the rebirth of the potentially vigorous private secondary mortgage market. In addition, the administration is expected soon to send to Congress its Trust for Investment in Mortgages—or TIM's proposal—designed to remove some of the tax and securities law impediments through placement of secondary market instruments.

In light of these developments, our legitimate concern should be the effect of raising the mortgage-purchase limits currently imposed on FNMA and FHLMC, and what effect this will have on the private activity, given the competitive advantage realized from FNMA's and FHLMC's quasi-agency status.

Because of these issues and the imminent arrival of the TIM's proposal, either Senator Garn or myself will conduct an additional hearing on the future of the secondary market within the month.

19-999 O-83—25

We will start with our secondary market panel. Our first panel on secondary markets this morning is Mr. Kenneth Thygerson, President of the Federal Home Loan Mortgage Corporation; Mr. David O. Maxwell, Chairman of the Federal National Mortgage Association; Mr. W. Gordon Hobgood, Jr., representing the American Bankers Association. I have to be particularly nice to him since one of his clients carries my overdraft. He will be accompanied by Mr. William W. Dwire, first vice president, National Bank of Detroit; and Mr. Willard Gourley, representing the Mortgage Bankers Association, president, Northwestern Mortgage Co. of Charlotte, NC.

We will proceed then with our first panel and let me first call on Mr. Thygerson. Gentlemen, let me say at the outset that you may submit complete statements for the record. They will be published in full in the record with any accompanying documents or data that you may want to submit for the record. We will be pleased to have you summarize your statements, particularly if they are very lengthy, so that we can expedite our business here this morning and give the members a chance to ask questions.

STATEMENT OF KENNETH J. THYGERSON, PRESIDENT, FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. THYGERSON. Mr. Chairman, thank you. It is my pleasure to be here today to discuss the evolving role of the secondary mortgage market and legislative recommendations to enable FHLMC to more effectively serve the housing credit demands of home buyers and housing credit liquidity needs of mortgage lenders.

Last month I reported to this committee that my outlook concerning the housing recovery is optimistic and FHLMC is aggressively broadening its support and services to assist in that recovery.

Over the past 6 months the Corporation's management has moved quickly to develop and introduce market innovations designed to enable mortgage lenders of all types and sizes easier access to our secondary market facility. My statement submitted for the record details the many changes we have made in the last few months.

Mr. Chairman, I have also attached to my testimony two analyses covering our rapidly changing housing and home finance market, the new players in this market, and the products and relationships that are emerging.

INCREASING RULE OF SECONDARY MARKET

In light of the increasing role of the secondary market, let me clearly state the near term goal of FHLMC. It is simply to apply all of our corporate resources to assist in the Nation's housing recovery. Even with the program improvements and innovations that we have developed over the past 6 months, the pace of change in the finance and housing markets will clearly require congressional attention, if we are to meet our near term goals of assisting the housing recovery.

Our home finance system, including the role of existing players as well as the entry of new housing market players, is still evolving. In the short term, Congress must assure that home buyers' access to the capital market operates as effectively and efficiently as possible. The secondary market must be granted maximum operational flexibility. FHLMC urges this committee to move as expeditiously as possible to provide us with the operational authorities that we feel are necessary to respond to the changing housing and finance market. Although I have attached, as an addendum to my testimony, detailed briefing papers on these operational authorities, let me very briefly highlight our legislative requests.

These requests involve increased real estate-lending flexibility consistent with our corporate charter.

We are requesting Charter Act authority to purchase loans and secured in whole or in part by manufactured housing loans, frequently called mobile home loans, classified as personal property.

We are requesting Charter Act authority to expand our current authority to purchase loans secured by junior liens. Our authority in this area is currently limited to loans where the proceeds are used for energy and home improvement purposes exclusively.

CHARTER ACT AUTHORITY

We are requesting Charter Act authority to purchase coventional mortgage loans insured by State housing finance agencies.

Finally, FHLMC is also requesting Congress to remove the statutory limitation on the maximum mortgage loan amount eligible for purchase by both FHLMC and FNMA.

Beyond these short-term needs, however, Congress is faced with the reality that the broader long-term issues related to the missions of each of the Government secondary market entities will have to be addressed. While we do not believe these long-term issues need to be resolved at this time, each should be identified and put in its proper perspective.

Generally speaking, these issues fall into three basic categories. The first is broader powers and includes the ability to make new markets and effectively support these markets.

The second is regulation. And includes those issues surrounding Government's control over Government-sponsored entities.

The third is structure. How will these entities do business and in what form?

On the issue of broader powers, the question of whether Government sponsored corporate entities such as ours should be authorized to provide secondary market facilities for other than housing will come before you with increasing frequency and pressure. Whether this matter is decided this year or sometime in the future is not the issue. The critical point is whether Congress is prepared to expand the scope of our function beyond that for which we were created, support for the housing market. This is a judgment that we believe Congress will eventually have to make. We believe it must be based on our ability to demonstrate that broader powers are not deletorious to our primary mission.

Congress will also have to assess whether broader powers outside the stated public purpose of fostering homeownership is appropriate, given the special status of Government sponsored corporations vis-a-vis the private sector. We do not believe FHLMC needs to make that assertion at this time. For now, all of our resources and efforts are best applied to the housing recovery.

Any discussion of broader powers must, of course, also lead to a consideration of the Government's regulation of our activities, particularly the favorable status enjoyed by Government sponsored corporations in the credit markets. Issues such as whether we should be so controlled, precisely how, and by whom, and for what public policy purpose reaches the very basis of our existence. Broader powers related to housing do not in and of themselves alter our public purpose or raise the issue of our status as a U.S. corporate instrumentality. Broader powers that go beyond our original purpose, however, do raise these policy concerns and, of course, provide Congress an opportunity to reevaluate our function and status as a Government-sponsored corporation and all that goes with that.

We are very delighted to hear that you are going to be sponsoring hearings later this month to deal with some of these substantive topics. These issues also relate to how we do business. FHLMC adheres to the philosophy and operating principle that we are a conduit operating between the primary market and the capital markets. We have endeavored to match our purchases with almost simultaneous and offsetting sales of pass-through securities. We price directly off the capital markets and thus avoid the asset liability maturity mismatches that involve significant interest-rate risks that are ultimately borne by the Federal Government.

These issues—broader powers outside the residential real estate markets, Government regulation and oversight, the question of how we do business—are issues that demand careful analysis and thoughtful review. We look to Congress to provide direction. FHLMC has an aggressive and innovative staff. They would obviously like to have the broadest playing field to play on. Thoughtful corporate executives cannot deny themselves or their stockholders greater flexibility in expanded powers. Must we now pause, however, and weigh those corporate goals against the reality of sound public policy? Congress can assist in providing us with the direction we need. We look forward to your decisions. Thank you.

[Complete statement follows:]

STATEMENT OF KENNETH J. THYGERSON, PRESIDENT, FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. Chairman and members of the committee, it is my pleasure to be here today to discuss the evolving role of the secondary mortgage market and legislative recommendations to enable Freddie Mac to more efficiently serve the housing credit demands of homebuyers and housing credit liquidity needs of mortgage lenders.

Last month, I reported to this committee that my outlook concerning the housing recovery is optimistic and that Freddie Mac is aggressively broadening its support and services to assist in that recovery. Over the past six months, the Corporation's management has moved quickly to develop and introduce market innovations designed to enable mortgage lenders of all types and sizes easier access to our secondary market facility. We have also introduced a responsive pricing system to ensure lender access to the most competitive interest rates for home lending on a daily basis. These innovations—combined with three new mortgage purchase programs and improvements to our guarantor program—are only our first steps in responding to a marketplace which is increasingly reliant on the secondary mortgage market for available and affordable housing credit.

The ferment among financial institutions generally and in the mortgage credit delivery system specifically has necessitated Freddie Mac's expanded role. Whereas our primary mission in 1970 was to assist the transfer of mortgage dollars from credit surplus states to housing credit deficit states, our future mission can no longer be drawn so narrowly. The combination of declining deposit financing of home mortgage credit by thrifts and rising mortgage credit needs stemming from demographic demands implies a tremendous increase in the volume of mortgage credit flowing through secondary markets. Indeed, the potential for secondary market growth is astounding. We estimate a potential for $225–$300 billion in secondary market activity in 1990, more than a six-fold increase.

Mr. Chairman, I have also attached to my testimony an analysis covering our rapidly changing housing and home finance markets, the new players in this market, and the products and relationships that are emerging (Tab No. 1). In light of the increasing role of the secondary market, let me clearly state the near term goal of Freddie Mac: To apply all corporate resources to assist in the nation's housing recovery.

To this end we have developed a series of new products which have been specifically designed to balance the needs of homebuyers, lenders, and investors with an emphasis on new loan originations.[1]

Just last month, I announced two new Freddie Mac programs in the short-term range. In mid-April we will begin to purchase two Adjustable Rate Mortgages (ARM's) indexed to the rate on Treasury securities. These will be 30-year instruments, one in which the rate adjusts every three years tied to the three-year Treasury rate, and one with five-year adjustments tied to the five-year Treasury rate. We are continuing to coordinate our efforts with Fannie Mae, so that after a lender originates a five-year ARM, it can be delivered to either organization. These instruments will meet the needs of lenders to, in effect, shorten the maturity of their mortgage assets, while giving borrowers some degree of payment stability.

In the intermediate term range, we have already begun to take commitments through Home Owners Mortgage Access Corporation (HOMAC) to purchase 15-year fixed-rate mortgages, and we will begin to purchase them for all of our seller/servicers in mid-April.

For long-term mortgages, our 30-year fixed-rate programs will always be important. We are also giving close attention to mortgage instruments which address the affordability needs of borrowers—in particular first time homebuyers. FHA experience has demonstrated the potential for widespread acceptance of graduated payment mortgages. We are therefore working on a Freddie Mac program for conventional GPMs.

A major innovation for 1983 will be the use of SWAPS for new originations. We will continue to work with thrifts as they search to find prudent ways to invest in longer term mortgages. Several conditions should be considered in this regard. First, these mortgages should be in security form. Second, the security should have high volume and be readily marketable. Third, the thrifts should be able to hedge these, for example, in established futures or forward cash markets. Our PCs fulfill all of these conditions. We want to give thrifts every opportunity to maintain their important position as the nation's supplier of home mortgages.

This broad range of new products provide what the homebuyer needs most—financing options to best fit the individual homebuyers' requirements.

MORTGAGE LENDERS NEEDS

Regarding the mortgage lenders needs, we will institute in mid-March a daily purchase program with an administered price for all of our single family mortgage products. This will allow our seller/servicers to price their products more effectively and assure their access to the most competitive interest rates available in the capital market. Additionally, the seller/servicer will have the flexibility to deliver these loans to the Corporation on a 30, 60, 90, or 120-day basis depending on their particular market. There are no fees and each period is separately priced to reflect the uncertainity of market rate fluctuations.

The third element of the secondary market, the investor, must also be provided a variety of housing investment opportunities within a range of maturity options—short, intermediate, and long-term. Our security products, which result from our loan purchase programs, will soon address a broader range of investor needs by providing securities bearing different maturities.

Even with the program improvements and innovations that we have developed over the past six months, the pace of change in the finance and housing markets may require Congressional attention if we are to meet our near-term goal of assisting the housing recovery to the fullest extent. The existing players (i.e., thrifts) as well as the entry of new housing market players (i.e., financial conglomerates), are still evolving. In the short-term, the Congress must assure that the homebuyers' access to the capital market operates as efficiently as possible and, in this regard, the secondary market must be granted maximum operational flexibility.

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[1] Tab 2 provides further explanation and description of many of Freddie Mac's recent innovations to improve the secondary market for housing and to respond to the changing marketplace.

Freddie Mac urges the Committee to move as expeditiously as possible to provide us the operational authorities we believe are necessary to respond to the changing housing and finance markets. Although I have attached as an appendix to my testimony detailed briefing papers on these operational authorities, let me briefly highlight our legislative requests (Tab No. 3). They all involve increased real estate lending flexibility consistent with our Federal Charter.

CHARTER ACT AUTHORITY

We are requesting Charter Act authority to purchase loans secured in whole or in part by manufactured housing loans classified as personal property. This authority will enable the Corporation to begin to develop a purchase program for what are commonly called mobile home loans. It is the Corporation's intent to develop a guaranteed security instrument in order to sell our manufactured housing loan purchases to the investment community once a purchase program proves successful in terms of volume, standardization, and price. With the authority to purchase this type of loan, Freddie Mac will be able to bring mobile home loans into the mainstream of the contemporary system of housing finance. This authority will allow the corporation to support the manufactured housing market, an affordable alternative to site built housing, for moderate and low income families, particularly first time homebuyers.

We are requesting Charter Act Authority to expand our current authority to purchase loans secured by junior liens. Although the Corporation now has a purchase program for secured energy and home improvement loans subordinate to first mortgage liens, the program has not been useful in assisting homeowners who need to secure secondary financing to enter homeownership or who wish to use their home equity for other than energy conservation or home improvement purposes (i.e., for educational purposes). Between 1979 and 1981, the volume of junior mortgage lien loans climbed from $9.5 billion to $19 billion. These figures do not account for the generally short-term junior liens resulting from seller held creative financing which is estimated to total between $10 and $15 billion in 1980 and 1981.

We are requesting Charter Act authority to purchase mortgage loans insured by state housing finance agencies as we would any other conventional mortgages. Currently, the Corporation cannot buy mortgage loans that have the benefit or state housing finance agency insurance under its conventional mortgage purchase programs. This restriction was imposed prior to the development of state housing agency insurance programs for home loans and is impeding our ability to respond to a changing marketplace. Although only three states and Puerto Rico have active state agency mortgage insurance programs, the Corporation believes it should be able to provide a secondary market outlet for this developing part of the housing market.

REMOVE STATUTORY LIMITATION

Freddie Mac is also requesting that Congress remove the statutory limitation on the maximum mortgage loan amount eligible to be purchased by both Fannie Mae and Freddie Mac. Currently, both corporations are restricted from providing a secondary market for mortgage loans over $108,300. This limitation creates unequal access for available housing credit dollars for regions and cities where average mortgage loan amounts are close to or exceed the statutory limit. For example, a home comparable to one costing $70,000 in Akron, Ohio costs $115,000 in Houston, Texas, $148,500 in Miami, Florida, $182,500 in New York City, (Suburban New York) New York and $253,000 in Orange County, California. Urban areas in particular are limited in their access to the secondary market. In 1982, nineteen SMSAs across the country had average home purchase prices above the Corporation's mortgage ceiling (FHLBB Interest Rate Survey). Loan balances are lower than house prices, reflecting down payments, but the house price data illustrates this regional disparity. As a result, the Corporation serves states with lower average home prices to a greater extent than higher cost areas. Removal of the limitations would result in equal access to the secondary market among all states notwithstanding the wide differential relating to average home purchase prices.

Our research has concluded that 10 to 12 percent of all homes sold in 1982 had mortgage loan amounts above the statutory limitation. Concern has been raised that with a removal of statutory loan limits, the Corporation will be unable to continue to serve the low and moderate homebuyer market because of capacity constraints caused by purchasing mortgages with higher loan amounts. Although we recognize this concern, Freddie Mac does not operate under any capacity constraints that would impede our ability to serve all segments of the market. In fact, we have already proven that we can rapidly expand our capacity to accomodate increases of volume. Evidence of this was clearly demonstrated in 1982, when FHLMC was able to increase its mortgage purchases over eight-fold in response to thrifts' needs to liquify their portfolios. Freddie Mac believes that it has developed its operations to the point that it can extend the advantage of marketability to high balance loans at no direct or indirect cost or harm to other segments of the housing market.

Beyond these shorter-term needs, the Congress is also faced with the reality that the broader issues elating to the long-term missions of each of the government secondary housing market entities will have to be addressed. While we do not believe these long-term issues need be resolved at this time for ourselves, each should be identified and put in its proper perspective. Generally speaking, they fall into three basic categories: Broader Powers—the ability to make new markets and effectively support those markets; Regulation—the government's control over its sponsored corporate instrumentalities; and Structure—how we do business and in what form.

BROADER POWERS

Regarding broader powers, the issue of the desirability or need for government sponsored corporations such as ourselves to provide secondary market facilities for other than housing credit will come before you with increasing frequency and pressure. Whether this matter is decided this year or some time in the future is not the issue. The critical point is whether Congress is prepared to expand the scope of our function beyond that for which we were created—support for the housing market. This is a judgment that we believe Congress will eventually have to make, and we believe it must be based on our ability to demonstrate that broader powers are not deleterious to our primary mission. Congress will also have to assess whether broader powers outside of the stated public purpose of "fostering homeownership" is appropriate given the special status of government corporations vis a vis the private sector. We do not believe Freddie Mac need make that assertion at this time. For now, all of our resources are best applied to the housing recovery.

Any discussion of broadened powers must, of course, lead to a consideration of the government's regulation of our activities, particularly the favorable status enjoyed by government sponsored corporations in the credit markets. Whether we should be so controlled, precisely how, by whom, and for what public purpose reaches the very basis for our existence. Broadened powers related to housing do not in and of themselves alter our public purpose or raise the issue of our status as a corporate instrumentality of the United States. Broadened powers that go beyond our original purpose, however, do raise these policy concerns and, of course, provide the Congress an opportunity to re-evaluate our function and status as a government corporation and all that goes with that status.

These issues also relate to how we do business. Freddie Mac has adhered to the philosophy and operating principal that we are a conduit operating between the primary market and the capital markets. We have endeavored to match our purchases with almost simultaneous and offsetting sales of pass-through securities. We price directly off the capital markets and have thus avoided asset/liability maturity mismatches that involve significant interest rate risks that are ultimately borne by the federal government.

These issues, broader powers outside the residential real estate markets, government regulation and oversight, and the question of how we do business are issues that demand careful analysis and thoughtful review. We look to the Congress to provide direction. Freddie Mac has an aggressive and innovative staff. They would obviously like to have the broadest field to play on. No thoughtful corporate executive could deny him or/herself greater flexibility in powers, in regulations, or in business approach. Must we now pause, however, and weigh those corporate goals against the realities of sound public policy? The Congress can assist in providing us with the direction we need. We look forward to your decisions.

Mr. Chairman, we look forward to working with the Committee on these issues. Over the next months, we will be providing recommendations for your consideration.

TAB 1 - THE MARKETPLACE

Much attention has been paid, and justifiably so, to the changing structure of the housing finance system. This appendix is intended to take a closer look at these changes and how they are affecting the delivery of home mortgage credit. The evolving role of the secondary mortgage market and the institutions which participate in this market, will be particularly focussed on. Also, trends within the housing market generally will be discussed.

A. Finance Market Changes - An Evolving Housing Finance System

Recent Activity

1982 was the fourth consecutive year of decline in the nation's new housing activity, and the worst for the housing sector on record for the post World War II period. Hidden behind these annual statistics, however, is a resurgence of activity during the second half of 1982. Total housing starts climbed 27 percent to an annual rate of 1.19 million units in the second half, from only 936,000 units in the first half. For single-family homes, the comparable increase in starts was 20 percent.

The driving force behind this revival has been the declining cost of financing home purchases. This drop in mortgage lending rates to homebuyers has been the direct result of declining capital market yields. In this respect, the current housing finance cycle differs from the traditional one. In the past, mortgage lending rates have fallen in response to a surge of savings inflows to thrift institutions--savings and loan associations and mutual savings banks--as market rates of interest fell. Now, because of the changing nature of the thrifts, the primary mortgage market is increasingly dependent for funds on capital market investors who are not mortgage lenders. The secondary mortgage market is the mechanism by which investor funds are transferred to mortgage lenders and capital market yield trends are translated into mortgage rate trends. As a result, the secondary mortgage market has been a key element in the housing revival we are currently seeing.

The importance of secondary markets and the link they provide between mortgage and capital markets is demonstrated by the activities of Freddie Mac, the largest issuer of conventional mortgage-backed securities. From June of 1982 to January of 1983, the yield at which investors purchased the corporation's mortgage-backed securities--called PCs for Participation Certificates--fell 375 basis points (from 15.88 percent to 12.11 percent), closely in line with the drop in other capital market rates. Because we could sell participations in mortgage pools at lower rates, we were able to reduce the yield at which we purchased mortgages from lenders by an almost identical amount. Consequently, lenders could and did originate loans at progressively lower rates to consumers.

The secondary mortgage market has always played a role in linking capital and mortgage markets. In the past, this link has been used primarily to keep mortgage rates in line with capital market rates. In the future, however, this link will also be used to provide a net increase in the supply of mortgage funds. Recent secondary market activity shows this is already occurring. Gross sales of FHA/VA and conventional home mortgages by the primary lenders (thrift institutions, commercial banks, and mortgage bankers) rose by over 35 percent in 1982 to $55 billion. This increase becomes even more dramatic when one considers that origination activity by these same lenders fell in 1982.

Not included in the sales figures just mentioned are the mortgage sales which are an integral part of the "swap" transactions designed and introduced by Freddie Mac in late 1981, and now also conducted by Fannie Mae. In our own program, called the Guarantor program, over $25 billion of home mortgages were swapped by lenders in 1982--that is, exchanged for Freddie Mac PCs. This program responded to the pressing needs of lenders, primarily thrift institutions, for more liquid portfolios by providing thrifts with a security that can be sold more easily than a whole mortgage.

Unlike other secondary market activity, SWAP sales have largely involved older mortgages with coupon yields well below current market rates. Some have questioned the extent to which secondary market activity in swapping old portfolio loans for mortgage-backed securities contributes to the housing recovery. Similarly, many have questioned whether secondary market activity in loans used to finance existing home sales or to refinance existing loans contributes to the recovery. All of this activity is as important to the housing upturn as are transactions in loans to finance new construction purchases.

First, SWAPs have provided needed liquidity to thrifts, improving their ability to assist in this recovery as they have in past recoveries. Many of the resultant mortgage securities have been sold to capital market investors, providing the thrift industry with fresh cash that will support additional mortgage lending.

Second, rising sales of existing homes are a prerequisite to a strong rebound of new home construction because they provide the necessary funds for consumers to upgrade to higher priced new homes. Most purchasers of new homes are not first time buyers, and therefore must sell an existing home before getting into the new home market.

Finally, the refinancing of existing loans is an activity that is vitally important to the health of the housing sector. The loans currently being refinanced include standard long-term mortgages that were originated at extremely high rates. They also include short-term balloon payment loans, originated as a solution to the acute problems in housing finance and now fraught with risks. The restructuring of this debt should put the housing sector on a sounder footing.

Primary and Secondary Market Participants

The increased importance of the secondary mortgage in the current housing recovery is a direct result of changing participants in the primary mortgage market. In the past, the bulk of home mortgage credit was originated and financed by thrift institutions--they financed over one-half of all mortgages and close to two-thirds of conventional mortgages. Thrifts' share of the primary market has been falling in recent years, however, and new lenders have been emerging. Mortgage bankers, who sell virtually all of the loans they originate, have increased their share of originations, while commercial banks have remained constant at about 20 percent. (See Figure 1.)

In addition, finance companies, credit unions, credit corporations, and others are entering the market at an unprecedented rate. For example, BANCO Mortgage, an originator of mortgage loans, has established a secondary mortgage corporation called Residential Funding Corporation (RFC). RFC purchases non-conforming loans (for example, high balance loans) and standard loans from savings and loans, mortgage bankers, commercial banks, etc., packages them into pools insured by MGIC (a private mortgage insurance firm), and issues mortgage-backed securities based on these pools with the help of Salomon Brothers. RFC has issued over $60 million in purchase commitments to date. General Electric Credit Corporation is planning a similar operation in which it will acquire and package mortgage loans, insure them, and issue mortgage securities backed by the mortgages.

Homebuilders are also playing a role in the secondary mortgage market. The Home Mortgage Access Corporation (HOMAC), a subsidiary of the Home Builders Association, provides builders with direct access to the secondary mortgage market by pooling builders' demand for mortgage credit. HOMAC then obtains commitments from the secondary market to purchase these loans.

The surge in new secondary market entrants can be added to an increase in activity by existing participants. For example, Salomon Brothers has rapidly increased its secondary market activities in mortgages and mortgage securities.

New entrants into the housing finance system are not limited to the secondary market. Sears has ventured into the primary mortgage market with the acquisition of savings and loan operations. Commercial Credit, traditionally a consumer and second mortgage lender, is diversifying its operations to enter the primary mortgage market. The list of new and expanded participants is not limited to those mentioned above. These are given merely as examples to demonstrate the rapidly changing world of housing finance.

Notwithstanding the surge in new participants in the housing finance market, thrifts' expertise in originating, servicing, and underwriting mortgage loans insures that they will continue to play an important role in originating mortgage credit. Recently enacted restructuring legislation giving thrifts broader asset and liability powers, however, implies that they will increasingly take on mortgage banking functions by selling an increasing percentage of originations in the secondary market. Thus, housing finance in the future will be more and more dependent on a supply of funds from the capital markets, and on secondary market conduits to provide the bridge between these markets.

The combination of declining deposit financing of home mortgage credit by thrifts and rising mortgage credit needs stemming from demographic demands (most notably the maturation of the baby boom), means a tremendous increase in the volume of mortgages flowing through the secondary market. Freddie Mac, Ginnie Mae, and Fannie Mae are now the principal mechanisms for an efficient, low cost transfer of mortgage funds from capital market investors to originators. However, the need and potential for growth in the conventional secondary market is significant and has resulted in the emergence of the new players mentioned above.

The Role of Secondary Markets

The housing finance system will increasingly rely on the secondary mortgage market for the delivery of home mortgage credit. To understand fully how and why this will happen, it is useful to look more closely at the role of secondary markets in the delivery of mortgage credit. In so doing, an important point will become clear. The key to the ability of secondary market institutions to provide tremendous benefit to homebuyers, without Congressional appropriation, is their interaction with, and reliance on, private financial market participants.

The most important function of the secondary market is to provide an elastic supply of funds to the mortgage market. That is, it ensures that funds are supplied in response to household demand, and that mortgage rates are in line with capital market rates. During the 1970s, it did this in two ways. First, secondary market activity moved funds from areas of the country with a surplus of mortgage funds to areas with a deficit. For example, institutions in the Northeast, with somewhat lower mortgage rates reflecting relatively weak loan demands and state imposed usury ceilings, and with large savings inflows, purchased mortgages for their portfolios. Those in the fast growing Sunbelt sold newly originated loans in order to liquify their portfolios to meet their heavy loan demands.

Second, secondary market activity helped broaden the market for home mortgages by creating the kinds of securities demanded by nontraditional investors, such as pension funds and life insurance companies. As a result, it was able to cushion the cyclical disintermediation in the thrift industry.

The challenge facing the secondary market today is considerably broader than in the past. In the 1980s, it must provide the mortgage market as a whole with a supply of funds from capital markets, and thus increase the net supply of mortgage credit.

To meet this challenge, a variety of links, or conduits, between mortgage and capital markets must be used. The most important are provided by the public and quasi-public entities, Freddie Mac, Ginnie Mae, and Fannie Mae. These institutions have Congressionally mandated goals, and special provisions to help achieve those goals. These special provisions may be summarized in the term "agency status." Agency status implies a number of things. It is important to remember, however, that the intrinsic value of what these institutions provide does not depend on their agency status.

The primary value of the institutions mentioned above is their ability to attract capital market investors into the mortgage market. One way they have done this is by offering investors attractive yields. Yield, however, is not the only consideration investors use in their investment decision. They are also concerned about cash flow, maturity, marketability, and risk. The secondary market institutions mentioned above have been successful because they have addressed these other characteristics as well.

Investors in whole mortgages demand higher yields on mortgages than on other investments, for example corporate or Treasury securities, because whole mortgages are at a disadvantage in providing these other characteristics.

First, mortgages differ from bond-type instruments because of differences in cash flow. That is, the principal is paid back gradually. This means the proceeds must be reinvested more frequently than with Treasury securities (or corporate bonds) which only pay off principal at maturity. The transaction costs of reinvesting principal, and the risk of not knowing what interest rates will be when the principal is reinvested, are important. Investors tend to require a premium because of this.

Second, the maturity of a mortgage is uncertain. The typical 30 year mortgage seldom lasts the entire thirty years. Most loans are prepaid, for example, if the homeowner decides to refinance or sell the house. If there is mortgage insurance, mortgages also "prepay" when there is a default and the claim is paid off. More importantly, the maturity is affected by interest rates. Since borrowers can refinance when interest rates fall, the maturity of the mortgage will fall as interest rates decline. Maturities will lengthen as interest rates rise, particularly if the mortgage is assumable.

Third, whole mortgage loans are not inherently marketable; the differences among borrowers and properties are very difficult to evaluate for those other than local specialists. Hence, investors require premiums to compensate them for the underwriting and other transaction costs of buying and selling mortgages, and for the interest rate risk they incur while trying to sell these loans.

Finally, mortgages require originating and servicing, and even with the best underwriting standards some defaults will occur. Capital market investors are generally not in a position to either perform these services or accept this default risk.

Secondary market conduits can eliminate much of the cash flow, marketability, and servicing and default risk disadvantages associated with mortgage investment through the use of mortgage-backed securities. A mortgage-backed security represents a pro rata share of a pool of underlying mortgages. They overcome the disadvantages of whole loan investment in several ways. First, they can be structured to have cash flows similar to that of bonds. (The exemption from grantor trust restrictions contained in the TIM proposal would allow even greater flexibility in this area). Second, by underwriting the loans, the need for investor underwriting is eliminated, and the securities are of a uniform quality. This provides one of the ingredients for marketability. The other ingredient is that the securities must trade in high volume. The mortgage-backed securities of Freddie Mac, Ginnie Mae, and Fannie Mae provide these marketability ingredients. They also reduce the default risk to investors by guaranteeing the security and diversifying default risk among many mortgage loans (pooling).

By providing the above characteristics to investors, the federally-related secondary mortgage institutions have provided an important link between capital and mortgage markets. The predominant link for the conventional mortgage market has been the Freddie Mac Mortgage Participation Certificate, or PC. Freddie Mac guarantees the timely payment of interest and full payment of principal on the mortgages underlying the PCs. It minimizes the risk of this guarantee by strictly underwriting all the loans it purchases, and by maintaining a reserve to cover losses. It avoids interest rate risk by matching mortgage purchases with sales of PCs. These two strategies have enabled Freddie Mac to be highly profitable in an environment that has severely tested unhedged portfolio lenders.

Since 1970, the Ginnie Mae MBS has provided the dominant link to capital markets for FHA-insured and VA-guaranteed mortgages. Ginnie Mae does not actually purchase mortgages and sell securities. Instead, it adds its guarantee to mortgage-backed securities which are issued by lenders. Ginnie Mae's guarantee of timely payment of principal and interest to investors carries the full faith and credit of the U.S. government. However, the risk implied by this guarantee is minimized because of the underlying FHA or VA backing for these mortgage loans, and because Ginnie Mae strictly underwrites all those who are allowed to issue Ginnie Mae securities, maintaining reserves against losses.

Fannie Mae has provided links to capital markets for both FHA/VA and conventional mortgages in a different manner. For the past 45 years, Fannie Mae has purchased long-term mortgages and issued short-term debt to finance these mortgages, taking on interest rate risk in the process.

In 1981, Fannie Mae began issuing mortgage passthroughs in the Freddie Mac/Ginnie Mae mold, to avoid this interest rate risk.

A key factor in the success of Freddie Mac, Fannie Mae, and Ginnie Mae has been their ability to participate in sophisticated financial markets with other private financial institutions. This has allowed them to attract capital market investors into mortgage investment without the need for Congressional appropriations. This ability has depended fundamentally on the acceptance of their contracts by investors. Moreover, the obligations of the secondary market institutions go beyond the legal contracts, to the expectations of investors. In this sense, changes imposed to achieve particular public benefits may actually hinder the ability of the secondary market to perform its role at all.

One example of the importance of the implicit and explicit expectations of investors and the importance in meeting these expectations is provided by the decision of Ginnie Mae to allow the inclusion of loans to builders in its pools between April 1 and August 31, 1981. According to the American Banker (July 18, 1980 and August 7, 1980), the purpose was "to help bail out builders with existing homes ready for sale" and "to help the sagging housing industry." The Public Services Association (PSA) objected to this practice because the construction loans were likely to prepay much faster than the loans to homebuyers, and because the percent of builder loans in each pool was not disclosed. PSA's self-regulatory affiliate (SRI) filed suit to stop Ginnie Mae from guaranteeing pools including these loans. Eventually an out-of-court settlement was reached. SRI's chairman said, "Ginnie Mae securities backed by pools containing builder loans are perceived in the market place to be a different financial instrument. The integrity of the market has been threatened by the presence of builder loans in Ginnie Mae pools." (American Banker, July 21, 1980.) The point is that attempting to achieve a simple public benefit in a technically legal way could have disrupted a multibillion dollar market and the benefits therein.

B. Housing Market Trends

In discussing the changing structure of the housing finance system, it is useful to take a brief look at trends in housing markets generally to ensure that the financing needs of all types of housing and homebuyers are met in the new housing finance system.

Throughout most of the last decade, new single-family homes showed a consistent improvement in terms of size and amenities. Significant increases in the real cost of homeownership in the past few years, however, have resulted in a tendency toward smaller, less elaborate houses. The expectation of continued high real homeownership costs has led analysts to predict that new houses will be smaller and more spartan in the coming years as well.

Consistent with the view that homes will be smaller is the implication that mobile homes (also known as manufactured housing) will become more important in fulfilling housing demand. Mobile home shipments have displayed relative strength in the current housing depression, accounting for 18 percent of the total supply of new housing units in 1981. Continuing improvements in product quality, relaxation of zoning restrictions, and the fact that mobile homes have their greatest acceptance in the Sunbelt and nonmetropolitan areas, which are enjoying the greatest population growth, imply that mobile homes may play an important role in meeting housing demand in the future.

The affordability considerations that will have a favorable effect on mobile homes sales will also affect condominium sales. The popularity of condominiums witnessed over the last five years reflects their success in providing an affordable alternative to the traditional detached single-family home, while still providing homeowners with an attractive inflation hedge.

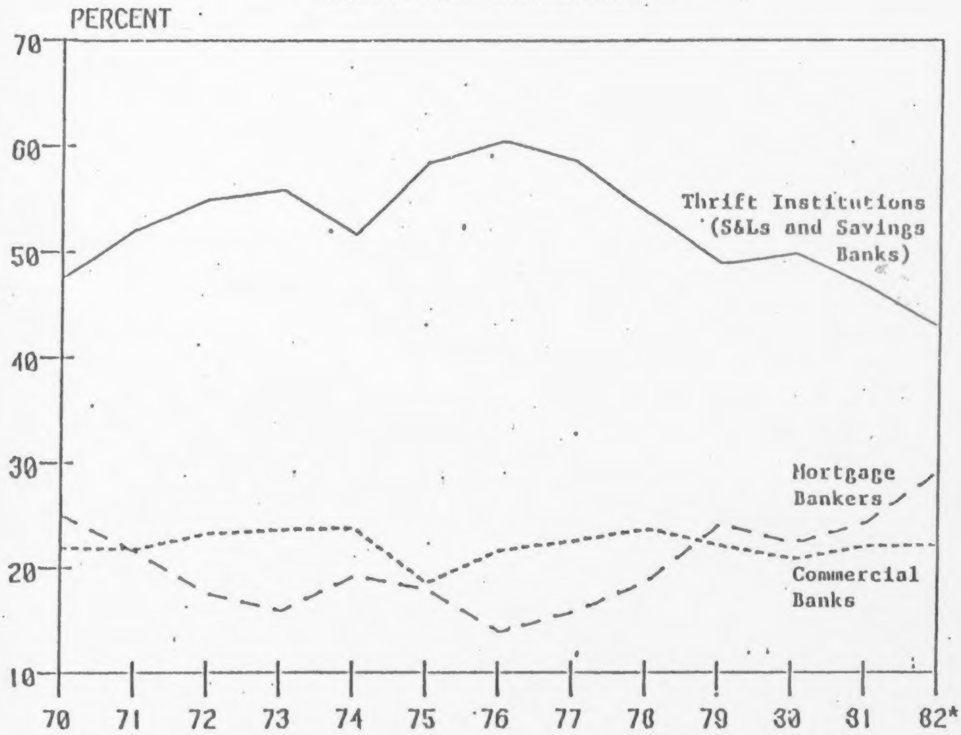
Despite a demographic shift in the mix of households toward older households that prefer single-family detached homes, favorable changes in the Economic Recovery Tax Act of 1981, along with an expected decline in the public role in multifamily housing, imply that the private multifamily market will be an important one in meeting the housing needs of the 1980s. Projections under "most likely" assumptions about economic growth and inflation show increases of over 25 percent in both 1983 and

1984 in multifamily housing starts. It is useful to note that because of the Economic Recovery Tax Act, multifamily properties will be depreciated more rapidly and sold more frequently than was previously the case. As a result, multifamily mortgage credit demand may increase faster than the expected increases in multifamily starts.

Demographic forces are shifting toward greater growth among the middle-aged families who tend to favor large detached homes. Nevertheless, alternative forms of housing such as mobile homes and condominiums, can be expected to play important roles, especially to the extent cash flow affordability problems are evident. The overall increase in the mortgage credit demands of the 1980s ensures this.

Figure 1

1-4 FAMILY MORTGAGE ORIGINATIONS
(FHA/VA AND CONVENTIONAL)



* Based on activity through the first nine months of 1982.

Source: HUD, "Quarterly Survey of Mortgage Lending." The HUD data covers origination activity by major lending groups. In addition to the above, life insurance companies, public and private pension funds, real estate investment trusts, federal credit agencies, and state and local credit agencies are surveyed. These other lenders have comprised 2-7 percent of total originations over the 1970s.

TAB II - FREDDIE MAC'S RESPONSE

New Products

The structure of the housing finance system is changing rapidly. As a direct consequence, the role of the primary and secondary market within that system, along with the participants and mortgage instruments in these markets, are also changing. Recent innovations and new products at Freddie Mac have been initiated, and will continue to be initiated, as a result. As one will notice, Freddie Mac's emphasis in 1983 will be on expanding the secondary market for new originations, although the Guarantor (or SWAP) program will continue to be improved to meet lenders' liquidity needs.

Primary Market

The volume of mortgage credit demand expected in the 1980s, combined with thrift's broadened asset and liability powers (and reduced emphasis on mortgage lending) requires that a wide variety of mortgage lenders participate in the delivery of mortgage credit. Their ability to do this, in turn, depends on their access to the secondary market. Freddie Mac is, therefore, expanding its customer base, and is reducing barriers in an effort to make it easier for all lenders to participate in Freddie Mac programs. Below are some of the steps Freddie Mac has already taken to achieve this goal.

- On November 1, 1982, Freddie Mac dropped the 50 basis point fee charged to non-members of the Federal Home Loan Bank System. This change increases access to the secondary market for conventional mortgages for commercial banks and mortgage bankers. Although historically thought of as FHA/VA originators, mortgage bankers increased their share of conventional originations to 17 percent for the first nine months of 1982. Commercial banks continued to originate about one-fourth of conventional loans. In addition, the change opens the door for emerging mortgage lenders such as credit unions and credit companies.

- Last November Freddie Mac began allowing million dollar SWAPs in the Guarantor program. This is the second reduction from the $10 million requirement when the program began in 1981.

- Freddie Mac announced that for the first time, certain fixed-rate, FHA-insured and VA-guaranteed mortgages may be swapped, as long as they are at least one year old loans on single-family homes.

- Further, Freddie Mac has simplified the seller/servicer application process, abolishing application fees and reducing paperwork.

Secondary Market

Changes to promote access to the secondary market are only as good as the day-to-day mechanisms that are in place for lenders to deliver their mortgages. The importance of these mechanisms has increased for two reasons. First, the increased volatility of financial markets requires more sophisticated programs to meet the needs of originators. Second, and more importantly, the volume of mortgage credit flowing through the secondary market will increase as a result of increased mortgage credit demands and restructuring in the housing finance system. As a result, a number of changes were announced that significantly improve the access for borrowers and lenders to the capital markets through Freddie Mac.

- Last month, Freddie Mac lifted the $5 million ceiling on the amount of home mortgages that lenders can sell in each weekly auction for the immediate delivery program. For noncompetitive bids, the limit was raised from $250,000 to $500,000.

- Freddie Mac has moved from a weekly to a daily posting of the yields at which offers for mandatory delivery commitments are accepted. This change will give lenders much greater flexibility in using Freddie Mac's programs and in managing their operations, including increased opportunities for hedging their risks.

- Most commitments were only available on a 60-day mandatory basis in the past. For most programs they will now be available for 30-, 60-, 90-, and 120-day mandatory delivery commitments. This greatly expands Freddie Mac's ability to meet the delivery needs of a wide range of mortgage lenders.

- Freddie Mac has joined forces with the Home Mortgage Access Corporation (HOMAC), a subsidiary of the National Association of Home Builders, to increase secondary market activity through a $500 million program. All of Freddie Mac's programs, and a new program to purchase 15 year fixed-rate mortgages, will be available to builders through HOMAC.

  Builders who are enrolled in the program will be able to obtain commitments to sell mortgages until the end of March. Until the end of this year, any approved seller/servicer may convert the HOMAC builder commitment into a Freddie Mac purchase contract.

  Initially, the builder reserves the funds for a one-half of one percent fee. HOMAC retains one-eighth of one percent, and pays three-eighths of one percent to Freddie Mac. However, the three-eighths fee paid is refunded directly to the builder when the reservation is converted to a Freddie Mac commitment.

- To handle the increasing volume and types of activities in the secondary market, Freddie Mac is updating processing capacity, making use of state of the art technology.

- A major initiative for 1983 will be the use of SWAPs for new originations.

Mortgage Instruments

The late 1970s witnessed an explosion of mortgage instruments as borrowers, lenders, and investors responded to a volatile financial environment. Adjustable rate mortgages with seemingly infinite variations in interest rate and loan payment adjustments emerged as lenders sought to avoid interest rate risk. Graduated payment mortgages, growing equity mortgages, shared equity mortgages, and buy-downs, all emerged as ways to rearrange the mortgage payments of borrowers to respond to record-breaking mortgage rates. As useful as the flexibility these instruments provides to individual borrowers and investors, these needs must ultimately be reconciled with the use of half a dozen to a dozen instruments. Without this standardization to a few homogenous mortgage instruments, the earlier mentioned marketability advantages of the secondary mortgage market will be impossible. The result will be an increase of the cost of homebuyers' mortgage credit.

One of the instruments that will continue to be important is the second mortgage. Advance Mortgage Corporation estimates that two out of every five mortgages issued by financial institutions in 1981 were second mortgages. Through the early and mid 70s, that was one in twenty. The impetus behind this growth is the extraordinary increase in housing values over the 1970s. As housing equities continue to grow, so too will the market for second loans.

A variation of a second mortgage is the credit line mortgage. With this mortgage, the borrower is approved for a maximum loan amount, depending on equity, which can be drawn upon as needed. Merrill Lynch has recently proposed such an account.

Freddie Mac is making many changes to accommodate the increase in mortgage instruments. This should not, however, require a great proliferation of mortgage instruments. As already mentioned, the needs of borrowers and investors can be mutually accommodated by developing a limited number of mortgage instruments. This move toward standardization is essential for mortgage-backed securities to trade in a volume large enough for the full benefits of the secondary markets to be achieved.

As a result, Freddie Mac is focusing on a few programs, which will be refined in response to borrower, lender, and investor needs. Whenever possible, mortgage instruments that have passed the market test will be replicated. The ultimate objective is to provide homebuyers and investors access to mortgages with a range of maturity structures--short, intermediate, and long term.

- Two new Freddie Mac programs in the short term range have been announced. In mid-April Freddie Mac will purchase two Adjustable Rate Mortgages (ARMs) indexed to the rate on Treasury securities. These will be 30 year instruments, one in which the rate adjusts every three years tied to the three year Treasury rate, and one with five year adjustments tied to the five year Treasury rate. Freddie Mac's efforts have been coordinated with Fannie Mae, so that after a lender originates a five year ARM, it can be delivered to either organization. These instruments are intended to meet the needs of lenders by, in effect, shortening the maturity of their mortgage assets, while giving borrowers some degree of payment stability.

- In the intermediate term range, Freddie Mac has begun to take commitments through HOMAC to purchase 15 year fixed-rate mortgages, and will begin to purchase them from all seller/servicers in mid-April.

- For long term mortgages, the 30 year, fixed-rate programs will always be important. Close attention is being given to mortgage instruments which address the affordability needs of borrowers--in particular first time homebuyers. FHA experience has demonstrated the potential for widespread acceptance of graduated payment mortgages. Freddie Mac is, therefore, working on a program for conventional GPMs.

TAB III

LEGISLATIVE AGENDA

AUTHORITY FOR FHLMC TO PURCHASE PERSONAL PROPERTY MANUFACTURED HOUSING LOANS

ISSUE: The corporation is seeking statutory authority to purchase loans secured in whole or in part by personal property manufactured housing.

AMENDMENT NEEDED: Section 302(h) of the Federal Home Loan Mortgage Corporation Act is amended by adding at the end thereof the following paragraph: "The term 'residential mortgage' is also deemed to include loans or advances of credit secured by mortgages or other liens against manufactured homes, whether the security property is real, personal or mixed."

LEGISLATIVE STATUS: The House housing bill, H.R.1, includes a provision to authorize the corporation to purchase personal property manufactured home loans by amending the term "residential mortgage" to include the following: "The term 'residential mortgage' is also deemed to include loans or advances of credit secured by mortgages or other liens against manufactured homes." In order to clarify that the authority specifically includes personal property loans, the corporation is requesting that this language be amended to include at the end of this sentence --, "whether the security property is real, personal or mixed." An identical amendment is being requested for inclusion in the Senate Housing bill.

BACKGROUND: Generally speaking, manufactured housing units that are not permanently affixed to real property are considered personal property under most state laws. Also, the vast majority of manufactured housing units are financed through retail installment credit contracts rather than by standard mortgage loan instruments. Although there is an active secondary market for FHA/VA manufactured housing loans, the national secondary mortgage market does not now provide an adequate outlet for conventional loans on personal property manufactured housing.

NEED FOR CHANGE: Manufactured housing represents an affordable alternative for moderate and low income families, particularly first time homebuyers, who have been priced out of the site-built housing market. As the manufactured housing market continues to grow, additional sources of credit will be needed to finance these homes. By removing current obstacles to the development of secondary market programs for conventional manufactured housing loans, an adequate supply of credit will be made available at competitive market rates for these home purchases.

AUTHORITY FOR FHLMC TO PURCHASE PERSONAL PROPERTY

MANUFACTURED HOUSING LOANS

CONCLUSION: Authority for the corporation to purchase these loans will expand housing opportunities particularly in rapidly developing regions where manufactured housing is becoming increasingly popular. The corporation's authority to purchase these loans may stimulate production as well as promote uniformity and standardization to this segment of the national housing market.

The corporation has begun exploring the complex issues raised by purchasing and selling conventional loans secured by personal property manufactured housing. This activity represents a significantly different line of business (installment credit) for the corporation. The corporation believes the development of a viable program could be completed as early as 1984.

REMOVAL OF FHLMC MORTGAGE LIMITS

ISSUE: The corporation is seeking removal of its statutory mortgage limits.

BACKGROUND: Under the Corporation's Charter Act, maximum mortgage limits are adjusted annually based upon a Federal Home Loan Bank Board Index of nationwide average home purchase prices. Mortgage limits for single family homes are currently $108,300. Prior to 1980, the mortgage limits were tied to the ceiling set for federal savings and loan associations under Section 5(c) of the Home Owners Loan Act. Mortgage limits for savings and loans were removed in 1980 by the Depository Institutions and Monetary Control Act of 1980.

AMENDMENT NEEDED: Section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act would be amended as follows: "(1) by striking out "shall" in the fifth sentence and inserting in lieu thereof "may"; and (2) by striking out the last four sentences thereof."

LEGISLATIVE STATUS: The 1982 Senate Housing Bill, S.2607, included a provision to remove the mortgage limits for FHLMC and FNMA.

NEED FOR CHANGE: Deregulation of the thrift industry has resulted in broadened asset and liability powers for thrifts, with less focus on home mortgage lending. Housing finance must, as a direct consequence, reduce its reliance on deposit financing and increase its reliance on secondary market financing. Since savings and loans and other primary market lenders can now originate residential loans without regard to any dollar ceiling, it follows that the corporation have the ability to purchase the residential mortgages originated by these lenders.

Maximum efficiency in the housing finance system will ensure that an adequate volume of credit is available at competitive rates. Currently, mortgage markets are segmented between those mortgages that can be sold in volume in the secondary markets and those that cannot. As a result, homebuyers desiring conventional loans in high cost areas, second mortgages, or a variety of alternative mortgage instruments not accepted by the secondary market corporations, must pay a premium on their rates because of limited access to the secondary market. Loan limits prevent FHLMC from achieving its full potential in reducing the cost of mortgage funds to all home purchasers by competitively tapping capital market dollars.

REMOVAL OF FHLMC MORTGAGE LIMITS

Support to moderate income homebuyers will not be diluted by removal of the mortgage limits. As the following chart demonstrates, the average conventional mortgage purchased by the corporation has been consistently below the purchase price ceiling implied by our loan limits. That is, it is the market, not Freddie Mac's loan limits, that are directing Freddie Mac's purchases to moderate income homebuyers. Regardless of changes in Freddie Mac's loans limits, leaders will continue to originate a wide spectrum of mortgage loans.

More importantly, the corporation purchases mortgage loans, pools these loans and sells them in the form of mortgage pass-through securities. Because of this financing mechanism, the corporation is not under any capacity constraints that would cause it to reduce its commitment to low and moderate income home purchasers if the loan ceiling is removed.

U.S. HOUSE PRICES

	U.S. Average Purchase Price Existing Homes	Average New Home Purchase Price	FHLMC - Average Home Purchase Price	Implicit FHLMC Purchase Price Ceiling (80% LTV Ratio)	FHLMC Mortgage Ceiling Single Family
1976	42,200	48,000	43,534	68,750	55,000
1977	47,900	54,200	47,193	68,750	55,000
1978	55,000	62,500	54,595	93,750	75,000
1979	64,200	71,800	60,352	93,750	75,000
1980	72,800	76,400	69,599	117,187	93,750
1981	78,300	83,000		123,125	98,500
1982	80,400	83,800		133,750	107,000

REMOVAL OF FHLMC MORTGAGE LIMITS

Equal access to the nationwide secondary market should be provided to parts of the country with a high cost of living. A home comparable to one costing $70,000 in Akron, Ohio costs $126,500 in Providence, Rhode Island, $135,000 in St Paul, Minnesota, $165,000 in Stamford, Connecticut and $253,000 in Orange County, California. Urban areas in particular are limited in their access to the secondary market. In 1982, nineteen SMSAs across the country had average home purchase prices above the corporation's mortgage ceiling (FHLBB Interest Rate Survey). As a result, the corporation serves states with lower average home prices to a greater extent than higher cost areas. Removal of the limitations would result in equal access to the secondary market among all states and cities notwithstanding the wide differentials relating to average home purchase prices.

Although FHLMC's implicit house price limit is above the national average price for both new and existing houses (preceeding Table on U.S. House Prices). This does not imply that the FHLMC/FNMA loan limit does not cause problems for moderate income homebuyers in high cost areas. The national average reflects wide variation in house prices. For example, in 1982, 10 to 12 percent of all new and existing houses sold, and roughly 25 to 30 percent of the actual dollar volume of house sales, were ineligible for purchase by FHLMC if the homebuyer obtained an 80 percent loan-to-value ratio mortgage loan. This indicates that over 250,000 loans on new and existing houses were denied access to secondary markets through FHLMC.

More important than the actual number of loans that are ineligible is the fact that the burden of this constraint is not distributed uniformly among housing markets. It is much greater in relatively high cost areas. House prices vary significantly by state, and particularly by city. While on average only 10 to 12 percent of the mortgages originated in 1982 were ineligible for sale to FHLMC or FNMA, there are high cost cities across the country where significantly more loans were not eligible for sale.

Hence, while FHLMC's loan limits were not a constraint for many homebuyers, they were a burden on significant numbers of borrowers in certain states. Removal of the limitations would result in equal access to the secondary market among all states and cities notwithstanding the wide differentials relating to average home purchase prices.

REMOVAL OF FHLMC MORTGAGE LIMITS

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CONCLUSION: The secondary market will play an essential role in the '80s in the delivery of mortgage credit. Removal of barriers such as mortgage ceilings will allow the corporation to better serve a broader segment of the housing market. This, in turn, will allow a broader segment of homebuyers to benefit in terms of lower costs and an increased supply of mortgage credit from the efficiency gains created by Freddie Mac's market making ability. With the authority to issue preferred stock, the corporation will be able to increase its support to all segments of the housing market on an equal footing in the future without in any way diluting its support to lower and moderate income homebuyers.

FHLMC AUTHORITY TO PURCHASE JUNIOR LIENS

ISSUE:

The corporation is seeking authority to purchase loans secured by junior liens the proceeds of which are not limited to energy and home improvement purposes.

AMENDMENT NEEDED:

The first sentence of section 302(h) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451(h)) is amended by striking the words "status as a first lien" and adding in lieu thereof the words "priority of lien status."

LEGISLATIVE STATUS:

The 1982 House housing bill, H.R.6296, included expanded authority for the Mortgage Corporation to purchase second mortgages not limited to home improvement and energy conservation purposes. The same bill was re-introduced by Chairman Gonzalez on January 3, 1983, as H.R.1. The House bill provision on second mortgages provides specific authority for the corporation to purchase these loans and sets certain restrictions on both FHLMC's and FNMA's second mortgage purchase programs. Among other things, the provision places limits on the purchase of second mortgages of $50,000 for one family residences and $60,000 for two to four family residences. Under the current bill, this authority would expire October 1, 1984.

H.R.1 refers to the purchase of "second" liens. This language would seem to preclude the purchase of third or fourth mortgages, which are becoming frequent vehicles for home finance. The corporation recommends that "junior" or "subordinate" lien would be a more appropriate term. The required eighty percent (80%) loan to value limitation in the bill would provide adequate protection, while allowing the benefits of the program to be made available to homeowners who have already drawn upon the equity in their home through an existing second mortgage or a secured home improvement loan.

FNMA was given authority to purchase second mortgages for all purposes in 1981 following removal of a HUD regulatory prohibition in this area.

NEED FOR CHANGE:

Market surveys indicate that the majority of homeowners who wish to obtain a loan secured by a junior lien generally seek loans which can be used for a variety of purposes, not strictly limited to energy and home improvement purposes. The attractiveness of the corporation's HIL program has been greatly reduced due to these limitations.

The volume of junior lien loan originations has grown dramatically in the 1980s. In 1979, the volume of residential first mortgages originated was $180 billion with an additional $9.5 billion in junior lien loans. In 1981, first mortgage originations fell to $93 billion, while junior lien loans climbed to $19 billion. These figures do not include seller junior liens which have been estimated to total between $10 and $15 billion in 1980 and 1981.

CONCLUSION: Authority for the corporation to purchase junior lien loans for purposes other than home improvement and energy conservation will expand the availability of various alternative mortgage financing tools such as purchase money mortgages. In California, the most frequently listed reason why borrowers seek junior lien loans is to make a balloon payment on a two to three year old "creative financing" loan. With this authority, the corporation will be able to expand home mortgage financing options for homebuyers. Without sufficient sales outlets in the secondary market, lenders must either reduce their originations of junior lien loans or hold these loans in portfolio, which they are less willing to do than in the past. An expanded secondary market for these loans will allow lenders to originate these loans at competitive market rates and pass along their interest rate risk, simultaneously replenishing their supply of funds for new originations.

The corporation has begun exploring the complex issues raised by purchasing and selling junior lien loans. The corporation believes that development of a viable program could be completed sometime in 1984.

AUTHORITY TO PURCHASE STATE AGENCY INSURED MORTGAGE LOANS

ISSUE: The corporation is seeking authority to purchase state agency insured conventional mortgages under its conventional mortgage purchase programs.

CURRENT RESTRICTION: Section 302(i) of the corporation's Charter Act: "The term 'conventional mortgage' means a mortgage other than a mortgage as to which the corporation has the benefit of any guaranty, insurance or other obligation by the United States or a state (emphasis added) or an agency or instrumentality of either."

AMENDMENT NEEDED: Section 302(i) would be amended as follows: "The term 'conventional mortgage' means a mortgage other than a mortgage as to which the Corporation has the benefit of any guaranty, insurance or other obligation by the United States or any of its agencies or instrumentalities."

EXPLANATION: Currently, the corporation under its conventional mortgage purchase programs, is restricted from buying mortgage loans which have the benefit of state agency insurance due to technical language defining the term "conventional mortgage". Deletion of state agency insured mortgages from the definition of "conventional mortgage" (Section 302(i) of the corporation's Charter Act) will enable the corporation to purchase, as part of its conventional mortgage programs, mortgages insured by state agencies. This change has been requested by the Puerto Rico Housing Bank and the State of New York Mortgage Agency, although the effects of the change will not be limited to these jurisdictions.

NEED FOR CHANGE: There are currently five state agencies which have insurance programs. One of these states, California, has not yet issued any insurance. The other four state agencies which issue insurance are Maryland, Vermont, New York and Puerto Rico. While the number of states which have state agency insurance functions is limited, it is expected that this trend will increase in the future.

AUTHORITY TO PURCHASE STATE AGENCY INSURED MORTGAGE LOANS

The corporation is seeking this legislation in order to provide needed secondary market support to these entities. Over the years, these state agencies have petitioned the corporation to become qualified insurers, so that loans which they insure will be eligible for purchase under the corporation's mortgage loan programs. The corporation is developing quidelines which will be used to qualify State Housing Finance Agencies which have insurance functions, once legislation is approved. The corporation supports the functions of these agencies, which in many cases provide mortgage insurance to low and moderate income homebuyers who are unable to obtain private mortgage insurance.

CONCLUSION: State insurance agencies were created to stimulate the flow of private investment capital into housing by creating a system to insure qualified lending institutions against losses resulting from non-payment of mortgages. The corporation supports this goal and, with the passage of this legislation, it will be able to act as a partner with state agencies to increase homeownership opportunities in these states.

SUMMARY OF STATE AGENCY INSURERS

MARYLAND HOUSING FUND

The Maryland Housing Fund issues insurance for both single and multifamily housing. The Maryland agency currently insures a very small percentage of the state's origination activity, around five percent (5%). The agency claims to experience less than one percent (1%) delinquencies and is rated AA by Standard and Poors.

VERMONT HOME MORTGAGE GUARANTEE BOARD

The Vermont agency is the most active state insurer. The agency insures primarily single-family housing secured by first liens, although it has insured two home improvement loans. The cumulative volume of single-family insurance issued by Vermont since the mid 1970s totals approximately $300 million. A survey done by the Guarantee Board in 1980 found that of 3,900 lender financed homes, 1,533 were insured by the state. According to the Guarantee Board, almost all mortgage insurance in Vermont for mortgages with loan-to-value ratios over eighty percent (80%) are done by the state. The agency receives a AA (S&P) rating and is currently experiencing a delinquency rate of one point thirty-three percent (1.33%) on its portfolio of insured mortgages.

AUTHORITY TO PURCHASE STATE AGENCY INSURED MORTGAGE LOANS

STATE OF NEW YORK MORTGAGE AGENCY

About thirty percent (30%) of the mortgages insured by the New York agency are for single-family properties, forty to fifty percent are for multifamily properties, and twenty to thirty percent are for commercial properties. The agency insurance program does not currently have a rating, but the Mortgage Agency as a whole is rated AA (S&P). The agency insures strictly the first lien and to this point reports a very small delinquency rate.

PUERTO RICO HOUSING BANK

According to agency staff, all insured loans must satisfy FHLMC and FNMA guidelines. The agency insures only first liens. The agency has not issued any bonds to date, but sources there estimate they would receive an A (S&P) rating on their conventional mortgage program. The bank's activity relative to the total amount of origination activity in Puerto Rico is most likely extremely small, although no firm figures are available as yet.

Senator **Tower**. Thank you, Mr. Thygerson.

Next we'll hear frm Mr. Maxwell from FNMA.

STATEMENT OF DAVID O. MAXWELL, CHAIRMAN, FEDERAL NATIONAL MORTGAGE ASSOCIATION

Mr. **Maxwell**. Mr. Chairman, I welcome the opportunity to appear before you and the committee today to discuss the important issues of the secondary market.

I would like to submit my full statement for the record and spend just a few minutes discussing some of the key issues that arise in connection with the legislative proposals regarding FNMA that are contained in the committee print. I would like to say, Mr. Chairman, that I am delighted and grateful that the subcommittee or the full committee will be holding additional hearings on the secondary market institutions within the month. We look forward to appearing at those hearings and to discussing in further detail our proposals and the reasons behind them.

I think everyone agrees that if inflation stays down and interest rates are under control, we have the potential for a great housing boom in the 1980's. the demand is there for housing, the need for housing is there, and this need will have to be met.

In this respect, everyone discussing this subject before the full committee and before this subcommittee has agreed that the secondary market will be of extraordinary importance in meeting that demand. This is particularly so because the thrift institutions have now been given both the power to have greater liberality with their assets and also the authority to attract deposits which are extremely short term.

I would like to say that as a matter of policy for the Federal National Mortgage Association, we believe, and I have so stated publicly on many occasions, that there should be additional private participation in the secondary market. I feel that as long as there are only GNMA, FHLMC, and FNMA, the full needs of the secondary market that will be upon us in the 1980's will not be met.

I would like to address myself in the rest of my testimony to the status of these institutions and to the reasons for our legislation. I will be brief and hope to expand on this at a later time.

I think that the advantages afforded to FNMA are somewhat misunderstood. After 12 years in which FNMA has been in the private sector a full consideration by this Committee is very much in order as to what those advantages actually are and what they are not.

For example, it is frequently and loosely said that we do not pay taxes. I would like to state right here that we do pay Federal income taxes at the full corporate rate of 46 percent, unlike our sister institution, the Federal Home Loan Mortgage Corporation. We do not have a bad debt.

Moreover, the interest paid on FNMA's debt is subject to State and local income taxes, unlike the debt of the Home Loan Banks and other such borrowers.

People say that we are able to borrow with special advantage in the credit market and I'm here to say, Mr. Chairman, that that might be true, but that does not always affect the rate that we must pay for the money that we borrow. In 1981, when I became chairman of this corporation, its financial condition was deteriorating rapidly. We brought in a new management team. We instituted new products. We reached out to new customers. We changed the way in which FNMA did business.

If we had not done that, the U.S. Government--if it has any moral obligation, and the article in the March 7 issue of Newsweek magazine written by Jane Bryant Quinn is very instructive on exactly what these advantages are and what they are not with respect to FNMA—and my colleagues in the banks and the thrift institutions, who own so much of our debt, would have been confronted with a problem which would have made Chrysler, New York City, and indeed Mexico, look like a picnic.

Now these things have to be said because there is much made of these so-called advantages and I think that the committee will want to really look behind them. The fact of the matter is that FNMA now has $40 billion in loans on its books that yield 10 percent or less. Many of those are FHA loans we have bought as part of our statutory obligation. Those loans are not going to go off our books. They are likely to remain there for at least 10 years and probably longer.

The fact of the matter is that our debt which we have to turn over, approximately $70 billion, has a life of 2 years and 3 months. FNMA must address the question of its ultimate financial soundness to continue to serve the housing market as we have done—and, Mr. Chairman, I point out that we bought $15 billion of loans in 1982 which was about 14 percent of all the mortgage loans made in the United States. If we do not have the strength to continue to carry out our mission, two things will happen. Housing will not have the support that it needs in the 1980's, and the jeopardy to FNMA could indeed cause serious problems for the U.S. Government based on this so-called moral obligation.

We have recently proposed a modest extension of our asset powers and we are willing to discuss this. As the staff of the committee knows and as the National Association of Realtors know, and as the other trade associations know, this is a matter which should be discussed. We believe that just as the savings and loans needed flexibility in their asset powers, FNMA, in order to survive and in order to carry out its basic mission to serve housing, must have some flexibility in those asset powers. And certainly we do not intend, nor could we if we did intend, to go out of the housing business, nor will we ever do so. And anyone that suggests to the contrary simply has not discussed the matter with me or the board of directors of FNMA or any of the other senior officers of the company.

MORTGAGE LIMITS SHOULD BE REMOVED

As far as the mortgage limits are concerned, we believe very strongly that those limits should be removed. The $108,300 limit on our mortgage purchases means that we cannot serve many areas of the Nation, including some in your own State, Mr. Chairman. For now there is no question that the national secondary market which is vital to housing and to jobs and to recovery in this country is served best by FNMA and FHLMC and.GNMA. Sure, there should be a private market, but we're talking about what needs to be done today, and those mortgage limits should be lifted in order to enable us to serve this national market.

Those organizations that are coming into the securities market on a private basis should be welcomed and we indeed are working hard to figure out ways in which it will be more possible for them to do so. We think that the private market should be expanded and we think that FHLMC and FNMA should be part of the private market. We want to be more private and we certainly want FHLMC to be more private.

But these are long term questions and for the time being the mortgage limits must be lifted.

As for HUD, we have proposed that the requirement of individual product approvals by HUD be removed. The fact of the matter is in order to conduct a $73 billion business you have to plan and you have to have flexibility and you have to be able to respond to the market, which is what we did in 1982. It is not feasible to do that with HUD having individual product authority; the proposed legislation would remove that.

For those authorities remaining with HUD, we believe that there should be a time limit on HUD's response and, Mr. Chairman, I can tell you that your committee put a time limit on HUD's approval of our mortgage backed securities program and the reaction was very different from the reaction to other proposals for other programs that we have submitted to the Department.

So, Mr. Chairman, I submit to you that this committee has an obligation to strengthen FNMA both for its long term viability and for the good of the housing market and we look forward to continuing the discussions of our legislative proposal and of these very important objectives.

Thank you.

[Committee insert of complete statement follows:]

Statement of

DAVID O. MAXWELL

Chairman and Chief Executive Officer
Federal National Mortgage Association

Before the
SENATE SUBCOMMITTEE ON HOUSING AND
URBAN AFFAIRS

March 10, 1983

Mr. Chairman and Members of the Subcommittee:

My name is David O. Maxwell. I am Chairman of the Board and Chief Executive Officer of Fannie Mae. I appreciate the opportunity to appear before this Subcommittee today. My testimony will cover the following:

- the role of the secondary market in providing a reliable source of funds for housing
- specific comments on the sections of the proposed Subcommittee bill that directly affect Fannie Mae

This is indeed an opportune time to be holding these hearings. While the housing and mortgage markets appear to be recovering from the record interest rates of the last several years, they remain highly vulnerable to a rebound in those rates. Now is the time to consider and make whatever structural changes may be necessary to assure a reliable flow of credit when rates do rise again -- and we know they will. We believe a number of the provisions in the Subcommittee bill would help with that restructuring, and I would like to explain why later in my testimony.

The Federal National Mortgage Association

First, though, because there are some new members on the Subcommittee, I would like to describe briefly what Fannie Mae is and what it does.

The Federal National Mortgage Association -- also known as FNMA or Fannie Mae -- began in 1938 as a subsidiary of the Reconstruction Finance Corporation, chartered by the Federal Housing Administrator. After several reorganizations, the Congress in 1968 separated Fannie Mae into two distinct organizations: Fannie Mae and the Government National Mortgage Association (GNMA or Ginnie Mae). Fannie Mae became a private shareholder-owned corporation, listed on the New York Stock Exchange, and supervised in certain respects by the Secretaries of Housing and Urban Development and Treasury. It has a 15-person Board of Directors. Ten directors are elected by the 30,000 holders of its 65,000,000 shares of common stock; the remaining five are appointed by the President. Fannie Mae pays federal income taxes at the full corporate rate. It owns approximately 1 of every 20 mortgages in the United States -- $75 billion of them. GNMA was established as part of the Department of Housing and

Urban Development to carry out government-subsidized mortgage programs and, through use of its full faith and credit guaranty, to help provide financing for FHA and VA mortgages.

When Fannie Mae became private, it paid the U. S. Treasury $216 million to purchase the preferred stock the government held, including the government's share of retained earnings. Fannie Mae's secondary market activities were limited to FHA/VA mortgages until 1970, when Congress authorized us to deal in conventional mortgages as well.

Fannie Mae was established to provide assistance, liquidity and stability to the home mortgage market. Fannie Mae operates in the secondary mortgage market. It purchases mortgages from financial institutions, such as mortgage bankers, savings and loan associations, and commercial and savings banks, to provide them money to lend people to buy homes. Fannie Mae obtains the money to purchase these mortgages largely through short- and medium-term borrowing in the capital markets. FNMA's year-old mortgage-backed security provides mortgage lenders with another means to generate cash for additional mortgage lending.

Fannie Mae's service as a financial intermediary improves the efficiency of the housing finance market, thus permitting housing to compete with other capital needs for investment dollars. Its operations transform mortgages from small, illiquid and local investments into corporate paper which attracts money to housing. The national scope of Fannie Mae's operations has increased the flow of mortgage funds among geographic regions of the nation. Fannie Mae has also worked with GNMA to increase the availability of low- and moderate-income housing.

Today, Fannie Mae holds $75 billion in mortgages, making it the largest mortgage portfolio investor in America. Some $39 billion are FHA and VA mortgages, most of which yield 10 percent or less. Fannie Mae finances this portfolio with $73 billion in debt, much of which is held by savings and loan associations and banks.

For years, Fannie Mae raised the money to buy mortgages by borrowing short-term at interest rates that were traditionally lower than long-term mortgage interest rates. From 1978 through much of 1982, this situation was reversed: short-term interest rates were higher than long-term mortgage interest rates. Furthermore, overall interest rates climbed to unprecedented levels. As a result, the rates Fannie Mae had to pay to roll over its debt have far exceeded the return on the mortgages in its portfolio.

As a result, Fannie Mae, which operated at a profit for most of its existence, during late 1981 and early 1982 was losing more than $1 million per business day. The spread between the average return on Fannie Mae's mortgages and the average cost of its debt turned negative in January 1980 and stood at a negative 1.44 percent in January, 1982.

Through a carefully crafted strategy, by January 1983 management reduced the negative spread to .50 percent, with most of the recovery (.88 of .94 percent) coming from the asset side, i.e., the purchase of new, high-yielding mortgages. That strategy consisted of seven basic elements including the purchase of high-yielding assets beyond our standard programs (we negotiated the purchase of $7.7 billion in "non-standard" loans during 1982); the institution of a second mortgage product to help lenders and borrowers; the "swapping" of nearly $11 billion in mortgage-backed securities for loans in the portfolios of thrift institutions -- providing them much-needed liquidity; and, the charging of fair and realistic fees, increasing our total fee income from $112.6 million in 1981 to $263.9 million in 1982.

During the troubled months of 1982, we purchased $15.1 billion in mortgages and guaranteed $15.5 billion in FNMA mortgage-backed securities. Fannie Mae's level of activity in 1982 was its highest ever, and this support was provided at a time when it was most needed by the market. You can imagine how we feel when builders and lenders say to us, as they frequently do, "Without Fannie Mae's help the last 18 months, we wouldn't be in business today."

Needed Changes in the Secondary Market

At this point, I would like to outline some of the changes we foresee in the secondary market. As traditional intermediaries such as thrifts and banks experience higher average costs and shorter average maturities on their retail deposits because of interest rate deregulation, long-term mortgage lending may seem less and less attractive as an outlet for those funds. This factor will require secondary market investors to play an increasingly greater role in mortgage finance if affordable capital is to remain available for housing.

The question is what can and must be done to restructure the secondary market to assure that it plays this role as efficiently and effectively as possible.

Congress has served the nation well by developing the federally sponsored institutions in today's secondary market. During the past decade of explosive growth in home ownership -- punctuated by credit crunches -- Fannie Mae, FHLMC and GNMA provided substantial liquidity to the home mortgage market. In doing so, they supplemented the mortgage investments of thrift institutions whose activity was also largely limited to home finance.

Now, the rules of the game have changed. Thrift institutions needed reasonable diversification in order to assure their economic viability and guarantee their ability to support housing. The Garn - St Germain Act did that, as attested to by the extraordinary inflow of funds into thrifts since that time because of the money market deposit accounts.

Reasonable diversification is also necessary for Fannie Mae, which serves the primary housing market both as a portfolio investor and as a conduit through the use of mortgage-backed securities. Fannie Mae's basic mission -- serving housing -- will never change. It is what we have always done, and will continue to do. But, we must be financially sound to serve this mission. When Congress in 1968 divided FNMA, setting up GNMA within the government and moving Fannie Mae into the private sector, few could foresee the economic turmoil in store for financial institutions at the end of the decade. The framers of the Fannie Mae Charter Act had every reason to believe the "agency" attributes bestowed upon the newly private company would more than suffice to enable it to remain self-supporting and to raise capital in the private market to support its mortgage-purchase activities. Indeed, it must have seemed then that the corporation's continued ability to borrow at favorable rates after it left the government would ensure its future prosperity in any conceivable economic circumstances. So it is not surprising that the company's modus operandi did not change materially in its transition from partial government ownership to full private ownership. Optional delivery commitments at fixed interest rates made Fannie Mae a true lender of last resort - and at rock-bottom fees for its services.

Fannie Mae's ordeal of the last few years has uncovered flaws in its basic structure and has proved beyond contradiction that it must be run like any other for-profit, taxpaying company if it is to survive and carry out its mission. The dedication of Fannie Mae's board and its management to that objective has enabled them to improve the company's financial condition and to give the housing market unprecedented support during the last 18 months.

Without Fannie Mae, a bad housing year would have been a disaster. Without Fannie Mae, many builders and some lenders might not be in business today. Because Fannie Mae provided a market for an extraordinary variety of adjustable rate loans, buy-downs, and other instruments, builders were able to move their inventory in local markets and lenders could earn origination and servicing fees.

Unfortunately, Fannie Mae remains vulnerable to sustained increases in interest rates. Every holder of fixed rate mortgages that finances them with liabilities having shorter terms is vulnerable. As I stated, Fannie Mae still owns an enormous portfolio of low-yielding loans. As a result, Fannie Mae suffers a negative spread on its portfolio. The life of its debt, which averages 2 years and 3 months, is much shorter than the life of its assets. Of those $75 billion in assets, approximately $39 billion are FHA-insured or VA-guaranteed, most with coupon rates of 10% or less. This means these loans will be on the books for a long time, Mr. Chairman, and will be the major asset-liability mismatch problem we face in the future.

Unlike the old Fannie Mae, however, the new Fannie Mae is planning strategies to cope with this mismatch. Not only must Fannie Mae be a sound investment for creditors and stockholders, it must be able to support the housing industry and mortgage market, particularly when times are bad, as they were in 1982. To do that, Fannie Mae must reduce to the greatest extent possible its vulnerability not only to economic storms but to the vagaries of political winds.

Now that the new management of Fannie Mae has succeeded in dealing with its immediate financial crisis and turning the company around, we must shift our attention to long-term growth and stability. This requires a number of structural changes in the way Fannie Mae and the rest of the secondary mortgage market operate.

As it was necessary to give primary portfolio lenders diversified asset powers to ensure their financial stability and their ability to continue to finance housing (as was done in the 1980 and 1982 Acts) so it is essential for entities in the secondary market, including Fannie Mae, to possess the flexibility to respond to the demands of the primary market quickly and effectively as well as the ability to help themselves financially. Such flexibility would enable Fannie Mae to meet the needs of the housing market throughout the housing cycle, as well as contribute to job creation and the economy's health.

Giving Fannie Mae the flexibility to purchase a wider array of real estate loans follows from providing broader asset powers to primary market institutions. As Jay Janis, past chairman of the FHLBB, remarked in a speech he made a few years ago:

> "Aided by Congress' action in passing the Depository Institutions Deregulation and Monetary Control Act of 1980 - an Act that granted wide new asset powers to savings and loan institutions - we have moved to give the thrift industry the maximum flexibility and freedom to maneuver.
>
> Granting that freedom was not a gratuitous favor to the savings and loan industry - it was the price of their survival in an economic environment that will not soon see a return to the halcyon days of cheap money, days when borrowing short and lending long was a formula for success, a formula that has become a prescription for disaster."

This applies equally to FNMA. We must be able to purchase the real estate products generated by the primary market not only to provide that market liquidity, but to enhance our financial viability.

Fannie Mae's long-term ability to serve housing requires priority attention to the asset side of the operations. Above all, there must be no repetition of the thrift institutions' difficulties that resulted from the mistake of adopting policies that increased borrowing costs before providing additional powers to acquire high-yielding assets. This was very devastating to the thrift industry. Therefore, Fannie Mae has requested authority to expand the types of real estate-related assets it may purchase along the same lines as the authority given to thrifts in the 1980 Act and the Garn - St Germain Depository Institutions Act of 1982. I will expand upon this later in my prepared remarks.

Second, a separate but related issue is the matter of HUD's regulatory power over Fannie Mae operations. Even at its best, the cumbersome nature of the regulatory process has meant costly and unnecessary delay in making available mortgage loan products of great benefit to consumers and opening new sources of funds for housing. While general oversight by the Congress and by the Secretaries of the Treasury and HUD is an understandable facet of Fannie Mae's status as a congressionally chartered private enterprise, the corporation must be able to serve the housing and real estate markets without undue delay in justifying the details of its products, either on the asset side or the liability side of its balance sheet. This is not meant to be a criticism of any particular administration. It indicates to me, however, that the Congress should adopt as its purpose to design and build institutions that will serve today's mortgage market with its fast-paced changes. The mortgage markets of today are very different from 1968 when FNMA was made private.

Like federally chartered banks and thrifts, Fannie Mae needs both to plan business strategies for years ahead, especially given the historic cyclicality in the housing market, and to respond to short-term market developments. That is almost impossible under the current regulatory structure and jeopardizes not only the financial viability of Fannie Mae, but our sustained capacity to support housing. Although some restructuring is necessary, I want to emphasize that we will not alter Fannie Mae's basic mission of providing housing to all Americans.

Long-Term Changes in the Secondary Market

Before addressing the proposed amendments in detail, I would like to respond to the Committee's request that I comment on the longer term structural issues we foresee in the years ahead as a result of changes in the primary and secondary mortgage markets. As I have attempted to demonstrate, I believe that the major issue with which the Committee must concern itself is a reliable flow of funds into mortgage investment.

During the next several years, this problem will begin to appear, albeit not to the extent that we expect in the late-

1980's. During the next few years, home builders and lenders will be adjusting to a more "normal" market and expected mortgage flows should be adequate. However, the next time rates rise, and they will, we will have a critical problem on our hands if we do not provide now for the flexibility that will be necessary to support the housing market. Fannie Mae and the other secondary market entities must be especially strong at this point.

As far as the secondary mortgage market is concerned, more private sector competitors are absolutely necessary. As I said, Congress acted very prudently by creating Fannie Mae, FHLMC and GNMA, but they cannot be expected to do the whole job. The private sector must be given greater incentives to develop its own secondary market institutions. Providing for the entry of these more private competitors is not easy, but it must be done.

Another area of interest to this Subcommittee is Fannie Mae's effort to activate its Netherlands-Antilles subsidiary to raise money overseas. The off-shore market not only offers a major source of additional capital, the intermediate and long-term maturities typical in the Eurobond market are well suited to match the maturity of domestic mortgage investments.

In order to tap this off-shore market, Fannie Mae needs approval from the U. S. Treasury to activate its Netherlands

Antilles subsidiary. Without authority to operate its off-shore financing subsidiary, Fannie Mae cannot help channel funds into housing from overseas the way other U. S. corporations have been able to use their off-shore subsidiaries to finance office machines, telephones and other products. FNMA is not asking for any special treatment, only parity for housing with other business purposes. Surely, housing is as important to our economy and to the American people as these other activities.

We hope this Subcommittee agrees with our proposal. We would welcome your help in obtaining the Treasury's approval of it.

The remainder of my testimony will address specific provisions of the Subcommittee bill affecting Fannie Mae. These fall into three categories:

(1) essential expansion of FNMA powers and activities;

(2) important modifications to the corporate structure; and

(3) vital changes in regulatory oversight by the Secretary of Housing and Urban Development.

Essential Expansion of Fannie Mae Powers and Activities

Several amendments in the bill would remove some of the limitations on Fannie Mae's powers and activities.

We strongly support the amendment expanding Fannie Mae's real estate-related asset powers. The corporation would be authorized to engage in all of its present lending activities, but would also be authorized to purchase, service, sell, lend on the security of, or otherwise deal in mortgages or other real estate-related loans and advances of credit constituting authorized investments for thrift institutions. This is a significantly narrower expansion of powers than was provided to thrifts under the 1980 Act or the Garn - St Germain Act, in that all Fannie Mae activities remain related to real estate. Much as thrifts are expected to stay committed to the residential financing market, Fannie Mae's expertise is as a secondary market purchaser of mortgages and we are committed to serving primarily that market. However, the ability to expand into other real estate-related areas, carefully circumscribed in the proposed amendment, will allow the corporation to serve as a better secondary market instrument for primary lenders and to mitigate the effects of interest rate fluctuations and cyclical conditions in the housing market as they affect the housing industry and Fannie Mae in particular. In short, these new authorities would permit Fannie Mae to better serve the mortgage market because of enhanced financial viability and because of a better match between what primary lenders can originate and FNMA can finance for them.

In addition, this amendment would remove Fannie Mae's maximum mortgage purchase limits -- now set at $108,300. We strongly support this as well. Homebuyers and sellers must compete in the broad capital markets for funds. We agree with the Subcommittee that it makes little sense to impose an arbitrary limit on that ability to compete. Further, because the limit is a nationwide standard, certain higher-cost areas in the country are significantly unserved.

Another amendment would remove current limits on Fannie Mae's ability to make loans on the security of mortgages and would permit Fannie Mae to offer temporary "warehousing" loans to builders in need of liquidity. It would also better accommodate the needs of lenders who seek longer-term financing through secured loans instead of sales of their mortgage instruments. Again, this expanded power will permit Fannie Mae to offer services required during particular periods in the housing cycle, especially when high interest rates accelerate the demand from builders and lenders. Many builders indicating interest in receiving secured loans were unable to take advantage of them because of the maximum 12-month term and overcollateralization required by the Charter Act. The Subcommittee amendment would remove these limits.

The final amendment in this category would permit Fannie Mae to guarantee mortgage-backed securities issued by approved lenders. This amendment would provide Fannie Mae and mortgage lenders added flexibility. We also support this proposal.

Important Modifications in Corporate Structure

Two amendments in the Committee print make important changes in the corporate structure of Fannie Mae. The first would expand the membership of Fannie Mae's board of directors from 15 to 18 by authorizing the shareholders to elect three additional directors. Fannie Mae is a large and complex business. A board of directors of 18 members is representative of comparable financial institutions such as banks and bank holding companies, which average 21 members. The additional three directors would give Fannie Mae more expertise at a crucial point in its corporate development. Therefore, we support this proposal.

We support having all three additional directors stockholder-elected rather than having any Presidentially appointed. We believe that five Presidentially appointed directors out of eighteen for Fannie Mae would represent the government's interest adequately. COMSAT and the National Corporation for Housing Partnerships, similar to Fannie Mae in that they are Federally chartered, have even less government representation. Further, we believe that the stockholders in our corporation are entitled to greater representation in return for making an investment in our company. The government has made no such investment.

The second amendment in this category authorizes the Fannie Mae Board to confer voting rights upon the holders of preferred stock -- a class of stock authorized for the corporation under a provision of the Garn - St Germain Depository Institutions Act. It is usual to provide limited voting rights to preferred stockholders, but a Charter Act amendment is required to include voting rights as one of the attributes the Fannie Mae Board may prescribe for preferred stock.

Changes in Regulatory Oversight by the Secretary of Housing and Urban Development

Three amendments in the bill deal with the relationship between Fannie Mae and the Secretary of Housing and Urban Development. The first would direct the Secretary to make annual reports to the Congress on the activities of the corporation under the Charter Act. This amendment retains the general regulatory oversight of the Secretary to assure that Fannie Mae carries out its Charter Act purposes. It does not contemplate that the Secretary would be involved in Fannie Mae's business decisions and would eliminate the current requirement that Fannie Mae receive this approval of the Secretary before it can deal in new conventional mortgage business activities. This latter authority was appropriate when Fannie Mae was first authorized to deal in conventional mortgages but has subsequently proven to result in substantial delay in Fannie Mae's efforts to implement business decisions in furtherance of its Charter Act purposes.

The second amendment would remove the requirement that Fannie Mae receive the approval of the Secretary before issuing securities, obligations or other instruments except that such approval would still be required for stock and debt obligations convertible into stock. The amendment would not change, however, the regulatory authority of the Secretary of the Treasury to approve issuances of Fannie Mae debt and mortgage-backed securities as prescribed by the Charter Act. We support this amendment because we do not believe that dual approval is necessary (in fact, the HUD Secretary has by regulation deferred to the Secretary of Treasury's approval in the case of debt), and we believe the HUD Secretary's responsibility to regulate obligational authority is unnecessary.

The third amendment follows precedent set in the Housing and Community Development Act of 1980 as to an amendment first offered by Senator Heinz. It would require the Secretary of Housing and Urban Development to respond within 45 days to a request for approval or other action under the Charter Act, with the right to extend that period by an additional 15 days if the Secretary requests additional information from the corporation. In the 1980 Act, the Secretary was given 90 days to respond to a request from Fannie Mae on beginning a conventional mortgage-backed securities program. That 90-day requirement worked remarkably well (on a very complex program) and we agree with the 45-day time limit for other Fannie Mae requests contained in the bill. If the Secretary disapproves the request, he or she must transmit to the Congress a report explaining the disapproval; if the Secretary fails to transmit the report to Congress within the 45 or 60 day period, as appropriate, the corporation is authorized to proceed as if the request has been approved.

The combined result of these amendments is to retain the Secretary's broad regulatory oversight of Fannie Mae, adding an annual report informing Congress about Fannie Mae's activities and support for its basic mission, along with particular authority to approve all Fannie Mae issuances of stock and debt obligations convertible into stock, to adjust the debt-to-capital ratio of the corporation and to approve the amount of Fannie Mae stock that must be held by sellers and servicers. These amendments retain oversight authority of the Secretary of Housing and Urban Development to assure and report to the Congress that the purposes of the Fannie Mae Charter Act are being carried out, while enabling the corporation to respond to the needs of the housing market without cumbersome and unnecessary delay. Therefore, we strongly support the inclusion of these HUD-related amendments.

Mr. Chairman, that concludes my prepared remarks. I will be happy to answer any questions you or the Committee may have.

Senator TOWER. Thank you, Mr. Maxwell.
Mr. HOBGOOD.

STATEMENT OF W. GORDON HOBGOOD, JR., REPRESENTING THE AMERICAN BANKERS ASSOCIATION, EXECUTIVE VICE PRESIDENT, TRUST, INTERFIRST BANK, DALLAS, TEX., ACCOMPANIED BY WILLIAM W. DWIRE, FIRST VICE PRESIDENT, NATIONAL BANK OF DETROIT

Mr. HOBGOOD. Thank you, Mr. Chairman.
[Complete statement follows:]

STATEMENT
OF THE
AMERICAN BANKERS ASSOCIATION

Mr. Chairman, I am W. Gordon Hobgood, Jr., Executive Vice President, Trust, Interfirst Bank, Dallas. Presently I serve as Chairman of the Asset Management Committee and member of the Executive Committee of the Trust Division of the American Bankers Association and I appear in that capacity. I am accompanied by William W. Dwire, First Vice President National Bank of Detroit and a member of the Executive Committee of the Housing and Real Estate Finance Division of the American Bankers Association. I would like to provide the committee with an overview of the problems with the secondary mortgage market. Mr. Dwire will address our concerns about those issues which affect banks' ability to originate mortgages. As you are aware Mr. Chairman, the ABA is a national trade association whose members consist of more than 13,000 banks, more than 90 percent of the full service banks in the United States.

We appreciate this opportunity to testify on the developments in the secondary mortgage market because commercial banks have the unique role of representing mortgage originators through their real estate finance and mortgage banking operations, and are also purchasers of mortgages. We will focus on the housing outlook, the state of the secondary mortgage market and the role of the commercial banks in the housing market.

Commercial Banks and the Housing Market

Commercial banks participate in the housing markets as one of a number of institutions that provide funding for housing the nation. We believe that the housing needs of the nation can best be filled by a freely competitive primary and secondary housing finance market. Although commercial banks are a major provider of housing finance they are not completely deregulated which results in a less efficient market.

The primary market is served by commercial banks originating and holding mortgages. Through the first three quarters of 1982, banks originated over $20 billion in mortgage loans for 1-4 family non-farm homes, almost 25% of all originations. At the end of September 1982, commercial banks held $162.6 billion in residential mortgages. Additional mortgages were held by bank trust companies. In regards to the secondary market, banks held $17.3 billion in debt securities of the three sponsored secondary market agencies and banks held over 20% of the total outstanding debt issues of the Federal National Mortgage Association. Additional bank participation in the secondary market is through their ownership of mortgage banking affiliates which originate loans for sale in the secondary market. Of the top 100 mortgage servicers, 44 are bank related, of which 40 are mortgage companies and 4 are banks.

The recent deregulation of the deposit market increases commercial banks' ability to compete with other institutions in the market for funds. We are grateful for this increased ability to compete for deposits but impediments remain on the lending side which prevent banks from taking full advantage of this deregulation. One of the effects of the deregulation is likely to be a change in the way financial institutions manage their balance sheets. With market rate deposit liabilities many institutions, including banks, will be wary of holding long-term fixed rate instruments. However, a well functioning secondary market will channel those instruments to participants willing to hold them, thus providing a means for all to maintain a balanced portfolio of assets. To accomplish this the secondary housing market instruments must be able to compete in the financial market.

As a result, legislative changes which result in easier access to the market are needed, and well-meaning legislation that would harm the operation of the housing finance market must be avoided.

Secondary market

The future of housing and real estate finance for commercial banks, savings and loans, mortgage bankers and other originators of real estate mortgages is directly tied to the ability of these institutions to sell mortgages in the secondary market. This market plays an increasingly important role in the provision for future housing needs and its importance will increase as deregulation proceeds and the role of the depository institutions changes.

Because of deregulation through such legislation as the Garn-St Germain Act, commercial banks are now better able to compete and offer their customers more competitive products and services. In order to manage the costs associated with being more competitive, we will, to a larger degree than in the past, utilize the opportunities which the secondary market offers. In other words, the management of our assets and liabilities will necessitate the need for a broader utilization of the secondary markets.

Through the creation of such institutions as Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), the Congress has shown its support for encouraging participation in the secondary markets. These government and quasi government institutions are actively facilitating the needs of the mortgage industry by purchasing mortgages from the originator and reselling them to investors. However, the current ceiling of $108,300 on loans eligible for purchase by the FNMA and the FHLMC severely restricts bank mortgage lending activities in many geographic markets. Without the ability to sell these loans in the secondary market, bankers will have less incentive to originate these loans.

Because of these organizations the housing industry has enjoyed the benefit of a highly competitive and efficient credit delivery system. We believe it is important that public policy do nothing to detract from such a system and would urge the government to play an active role in assuring the maintenance of a pro-competitive environment. Our concern lies in policies that may result in serious deviations from the pro-competitive environment and result in long-term adverse effects on the market. The organizations were established to fill voids in the marketplace that were not being served by private institutions for one reason or another. These organizations have certain advantages not available to the other players, such as agency status for their debt obligations and exemptions from certain taxes. As long as they are operating and providing service in areas that otherwise would not be served, the advantages are justified. However, once the markets are developed and private institutions also participate in the market these advantages can and should be eliminated. Otherwise, certain areas of the credit market will be subsidized by the areas that do not have the federally mandated advantages.

An example that bears out our fears is the evolution of the Cooperative Farm Credit System (CFCS). This has become the largest single lender to agriculture. Although we recognize the important role played by the CFCS in providing farm credit, it is entering traditional areas of banking while remaining free from the controls and requirements of the

Federal Reserve System, the FDIC and the Comptroller of the Currency. This has resulted in negative effects on the competitive climate for agricultural lending. We fear a similar occurance in the market for mortgage lending.

In order for the secondary markets to remain responsive to the needs of the housing finance industry, we have identified two areas of concern. The first involves current regulation which unduly restricts participation in these markets. The second area of concern, related to the first, deals with the uniqueness of the mortgage "pass-through" certificate which because of its complexity hinders the use by commercial bank trust departments and pension funds.

Many potential suppliers of funds to the housing market are inhibited by regulations that essentially foreclose purchase of instruments backed by mortgages. These potential participants include insurance companies, pension funds and bank trust departments. Our Association has testified on numerous occasions on the difficulties caused by ERISA, which contains sweeping prohibitions on transactions between employee benefit plans and a broad category of persons called parties in interest. Attachment I contains previous testimony of the Association's position on this issue.

Exempted from the prohibited transaction provisions are blind security purchases or sales through a broker. But mortgages, mortgage-related investments and other direct or private placements have become a nightmare of complexity because of ERISA prohibitions, the breadth of parties in interest and the number and variety of service providers who may be involved in these transactions. The need to request exemption from the Department of Labor prior to entering certain transactions serves to deter pension plans from investing in many productive assets.

Recent efforts by the Department of Labor to exempt certain mortgage related transactions are encouraging. In addition, the Department on its own initiative has proposed exemption relief from the prohibited transaction provisions for certain qualified professional asset managers. Our Association is testifying this morning before the Department in support of that proposal. But much more remains to be done, especially with respect to the overly broad definition of party in interest.

As mentioned earlier, we are also concerned with the uniqueness and complexity of the "pass-through" certificates. The likelihood that these instruments will be prepaid sometime before maturity creates uncertainty about their yield and future maturity. In other words, the characteristics which make a bond so attractive to bank trust departments, pension funds and others — its liquidity, semi-annual payment of interest, predictable maturity schedule, and safety — would not necessarily be present in a mortgage backed security. Without all these characteristics, mortgage type investments will not be competitive with bonds.

We are aware of the Administration's proposal identified as Trust Investments in Mortgages, or TIMS for short, which incorporates a taxable mortgage-backed security on conventional residential loans. Accompanied by regulatory changes, this would create a more flexible investment vehicle. This type of investment, structured correctly, could allow pension funds to enter the largely untapped field of private mortgage securities, estimated to be approximately $41 billion during this year.

In our testimony given last May before the Senate Finance Committee's Subcommittee on Savings, Pensions, and Investment Policy (Attachment I), we recommended the development of a new instrument which will attract institutional funds into residential mortgages without all the difficulties or burdens one encounters from the current regulatory environment. We further stated at that time and continue to support efforts which will develop an instrument with a high degree of liquidity, be of readily ascertainable value, offer certainty of time and amount of repayment and most importantly be operationally simple.

In summary Mr. Chairman, the secondary market is the key which will provide commercial banks and others the opportunity to better manage their funds in a deregulated environment. We would urge this committee to support efforts which would broaden the activity and growth of the secondary market for mortgage backed securities.

Implementation of legislation

Mr. Chairman, we are pleased with the initiative taken by Congress last year in regards to specific sections of the Garn-St Germain Act dealing with real estate finance. It has long been the goal of our Association that such items as the enforcement of due-on-sale and mortgage lending relief for commercial banks be addressed and we applaud your active participation in the passage of that legislation. It is equally important for our members to expect in an expeditious fashion regulations from the appropriate federal agencies in order that the provisions of the legislation may be carried out. Absent these regulations, commercial banks are operating at a significant competitive disadvantage to other mortgage lenders and as a result are hesitant to provide additional funds to the housing market.

Section 341 of the Garn-St Germain Act authorized the Comptroller of the Currency to limit state restrictions on the enforceability of due-on-sale clauses in national bank mortgage loans. So long as state restrictions are not abated, national bank real estate loan portfolios in the sixteen or so states that limit due-on-sale enforcement will remain illiquid and, in many cases, below market, making sales to the secondary market difficult and placing a drag on bank earnings from real estate operations. This disincentive to mortgage lending is now unnecessary as both the Federal Home Loan Bank Board, for Federal savings and loan associations, and the National Credit Union Administration, for Federal credit unions, have already preempted state restrictions on due-on-sale enforceability. As of this date, the Comptroller has not yet issued regulations which would clarify the due-on-sale situation for commercial banks.

Although it has until mid-April, the Comptroller has also failed to issue even proposed regulations to implement Section 403 of the Garn-St Germain Act. That section removed many statutory restrictions on national bank loan-to-value ratios in mortgage lending, maturity of mortgage loans, and amortization of real estate loans. The thrift industry has been operating for almost two years under mortgage lending regulations more flexible and responsive to market changes than those governing national banks. Under those conditions, national banks have little incentive to develop innovative mortgage lending plans to take advantage of the renascent real estate market.

In addition, revised alternative mortgage lending regulations, first proposed by the Comptroller's Office in June 1982, will, we understand, be finalized this week. National banks have been limited to participating in only two of the eight secondary market mortgage programs of the Federal National Mortgage Association. We expect the final regulations will expand national bank secondary market opportunities by allowing greater flexibility for banks in the design of mortgage products of interest to both consumers and investors. We would note that, under Title VIII of the Garn-St Germain Act, state banks would be free to take advantage of the Comptroller's alternative mortgage lending regulations when they are issued. Thus, these regulations are doubly important to the competitive posture of commercial banks in real estate lending and to the potential growth of bank housing finance activities.

Economic Recovery

Mr. Chairman, there will be some housing and community development legislation coming out of this session of Congress. We feel that the economic picture needs to be put in perspective and kept in mind as the legislation is developed. There is general agreement that the economy is recovering from the recession. Our Association's Economic Advisory Committee (a group of leading bank economists) met in early February and gave their views on the prospects for the economy. They felt that the recession was probably over and 1983 will be a recovery year because of stimulatory or at least accomodative fiscal and monetary policies. In addition, inventory positions are generally lean and the financial condition of the employed consumer has improved during the last year. Although interest rates are still high, they are down significantly from the levels of a year ago.

Much of the improvement is a result of the President's economic program. The program has four main elements: reduction in the rate of growth of government spending and taxes, monetary policy designed to reduce inflation and a program to reduce the regulatory burden on businesses and individuals. Inflation has decreased but the deficits still remain high.

The current deficits and the large future estimated on and off budget deficits of over $200 billion in FY 1984 and FY 1985 and $150 billion in FY 1986 and FY 1987 result in real interest rates that are higher than they would have been at lower deficit levels. Expenditure cuts should be used to reduce the budget deficit and decrease their adverse effects. All sectors of expenditures should be candidates for reduction. Since defense and direct benefit payments for individuals will make up about 71 percent of government expenditures in 1984 according to the recommended budget, these areas must be closely examined.

The housing market is responding favorably to the fall in the mortgage rates. From highs of over 15% in late 1981 mortgage rates have now decreased by over 2 1/2 percent. As a result, housing starts, building permits and sales of new single-family homes have all started to increase from their previous low levels. As noted by Chairman Pratt in his testimony before this committee, housing starts in December were 43 percent higher than the October 1981 low. Housing permits have been over the one million annual rate for five of the last six months. In addition, new single-family home sales have exceeded the one-half million rate for the last two months and the December rate was 54 percent above its September 1981 trough.

Delinquincies, foreclosures and legislation

Although the economy is recovering, foreclosures and delinquencies remain high. This has resulted in discussion of legislation which would ease the problems faced by homeowners who are unable to meet their mortgage payments. Essential to the functioning of a freely competitive market is the assumption that the terms of a contract will be upheld. Any type of legislation that interferes with the contract made between a borrower and lender will have a devastating effect on the housing finance market.

If legislation of this type was passed, the secondary market would swiftly contract and mortgage originators would be unable to sell their loans if they desired. Potential purchasers of mortgage backed securities would be unwilling to hold securities because greater uncertainty of repayment would result. Mortgage lenders would be markedly less inclined to originate new mortgage loans if those loans did not have the potential to be sold in the secondary market. To ensure the continued ability of the housing finance market to compete for funds in the capital markets, legislation of this type must be avoided.

The economic picture needs to be kept in mind in developing any type of legislative relief. The economy is recovering with the housing market leading the recovery. Because of this and the fact that bankers are already working closely with economically distressed homeowners to avoid defaults, legislation to aid the housing market as a whole is not needed. What is needed, as we stated before, is legislation to aid the functioning of the market. In considering legislation, we would caution against legislation which results in increased deficits. Increased deficits would lead to higher interest rates and result in a slowdown in the economic recovery, making everybody worse off. Consequently any program considered should be narrow in scope and closely and carefully targeted only to the poor and not be the type of program that would allow those that have the ability to pay to take advantage of the legislation, substituting government funds for private funds.

Increased Participation by Commercial Banks

We are pleased to hear that Senator Garn has scheduled a hearing on additional areas of deregulation for the depository institutions. We believe that deregulation is needed to allow banks to remain competitive with other participants in the financial market. Our Association by various means is currently preparing its members for further deregulation. Our Housing and Real Estate Finance Division commissioned two studies on the real estate market and the future of commercial bank financial services in these areas (Attachments II and III). The first study examined the residential housing market and concluded that the secondary market will be of increased importance for providing funds to finance the housing needs. The second study analyzed the non-residential real estate market. It concluded that real estate debt/equity financing will be of continued importance for the housing market. In addition, a recently completed study commissioned by the American Bankers Association and conducted by Arthur Young analyzed 13 potential markets for commercial banks and assessed the feasibility and profitability of bank entry into these markets. Two of the markets analyzed were real estate brokerage and real estate equity participation, both of which commercial banks are presently restricted from entering. The results for these two markets indicate that banks are well positioned for entry into these markets. In the area of real estate brokerage, banks could offer the service to both their retail and commercial customers. They could use their existing distribution network and their computerized information service to aid in providing this service.

Banks are ready and willing to compete in a deregulated environment, but are prevented from entering various markets. As stated above, banks are well positioned for real estate equity participation but currently are restricted from that area. Commercial banks currently represent the only major source of real estate finance that is proscribed from engaging in joint venture/equity participation financing. Savings and loans through their service corporations, independent mortgage bankers, insurance companies and even municipal governments are increasingly providing this type of financing, particularly for housing construction. While lack of this authority places banks at a competitive disadvantage, it also restricts the capacity of banks to provide financing structured to meet the needs of builders and consumers.

Conclusion

Mr. Chairman, we appreciate this opportunity to express our views on the secondary housing market. The secondary market is in a state of ferment. Various changes are occurring due to the two recent legislative efforts, the Depository Institution Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Act of 1982. To strengthen the secondary market, additional participants such as pension funds are needed as well as mortgaged backed securities that are competitive with existing market instruments. Although the market needs additional development, already the benefits from the existence of the secondary market are obvious. We urge you to initiate legislation that would strengthen the secondary mortgage market and increase the ability of commercial banks to participate in it.

Attachment I

Mr. Chairman, I am W. Gordon Hobgood, Jr., Executive Vice President, Trust, First National Bank in Dallas. Presently I serve as Chairman of the Asset Management Committee of the Trust Division of the American Bankers Association and I appear in that capacity. ABA is a national trade association whose members consist of more than 13,000 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another.

We are pleased to discuss with you and the members of the subcommittee, mortgage investment by pension funds. We congratulate you for holding this hearing to address the impediments which serve to discourage mortgage investment.

ABA has testified on numerous occasions before this and other Congressional committees on the difficulties ERISA's prohibited transactions cause plan fiduciaries and investment managers. These provisions are the overriding problem we have with ERISA in administering plans. In our view it is these prohibitions, contained in Section 406 of ERISA, which serve as a major deterrent to investment of employee benefit plans in assets other than stocks, bonds and other publicly traded securities through brokers.

The provisons enumerate a broad list of transactions into which a fiduciary may not cause a plan to enter.

Subsection (a) of Section 406 lists the activities into which a fiduciary may not cause a plan to enter with a "party in interest", while Subsection (b) prohibits transactions which are essentially self-dealing in nature. A "party in interest" is defined to include an almost limitless class: an employer, or 50 percent owner of an employer, whose employees are covered by the plan, any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10 percent shareholder or partner or joint venturer of an employer, service provider to the plan or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use by a party in interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business.

The number and variety of possible transactions that are prohibited are enormous and the vast majority would be innocently entered into in the plan participants' best interests. It is unreasonably burdensome for even the most diligent trustee to keep track of or even know the ever changing list of parties in interest and to review all these relationships with respect to each and every plan transaction. This is particularly true where large U.S. companies and large plans are involved. It is exceedingly difficult if not impossible for a bank trustee to even know of all the various employers in a Taft-Hartley trust, particulary when there would be no other reason to know them except for prospective prohibited transactions. Implementation of the needed procedures is expensive and time consuming, and serves no productive purpose other than avoidance of a violation of these provisions.

The prohibited transaction provisions do not apply to security purchases or sales where there is a blind purchase through a broker. But mortgages, mortgage-related investments and other direct or private placements have become a nightmare of complexity because of Section 406(a), and the breadth of parties in interest and the number and variety of service providers who may be involved in these transactions.

Because our experiences with the exemptive procedures of the Department of Labor have been unsatisfactory to date, ABA has repeatedly urged repeal of the prohibited transactions provision, at least that portion relating to transactions with parties in interest. We believe the standards of undivided loyalty, exclusive purpose and prudence contained in other provisions in ERISA make Section

406(a) redundant and unnecessarily burdensome.

At the same time Mr. Chairman, we recognize that a new emphasis exists within the Department of Labor and that efforts to eliminate some of the burdens have begun. We understand that the mortgage exemption proposed last December will be issued soon and that a class exemption for mortgage pool investment trusts will be issued. Also the Secretary of Labor announced and we understand the staff has begun work on an additional exemption from the party in interest prohibited transactions for certain qualified professional asset managers and that there may be some consideration given to narrowing the needlessly broad scope of "party in interest" to eliminate those parties which are more remote to particular plan transactions. Our Association applauds the direction of these efforts. At the same time we must recognize that administrations and individuals change. Therefore, short of repeal of Section 406(a), ABA urges that Congress codify these exemptions.

In addition to the difficulties caused by the prohibited transactions provisions investment considerations and operational factors influence a portfolio manager's decision to invest or not to invest in residential mortgages. Liquidity is one important consideration. Mortgages are simply not readily saleable nor are GNMA or other pass through certificates as readily marketable as competing instruments. Committing funds for as long as 30 years in today's volatile interest rate and uncertain investment climate may be called into question. Professional investors are understandably reluctant to commit themselves to even long term governments and high grade corporate issues with extended maturities.

Mortgages are costly to acquire because of the documentation relating to title, security, recording and the like which must be checked even when purchasing "packages" of mortgages. After acquisition, mortgages present accounting and operational problems unique from most competing investments. GNMA and other mortgage-backed certificates help to alleviate some of these problems but in the process they produce their own difficulties. Payments are notoriously late, often more than two weeks after payable date and, because of principal prepayments, uncertain in amount. Because of these unique characteristics, even though mortgage rates are today very high, the costs of handling mortgage investments are also high and thus the net yield is often less than competing investments.

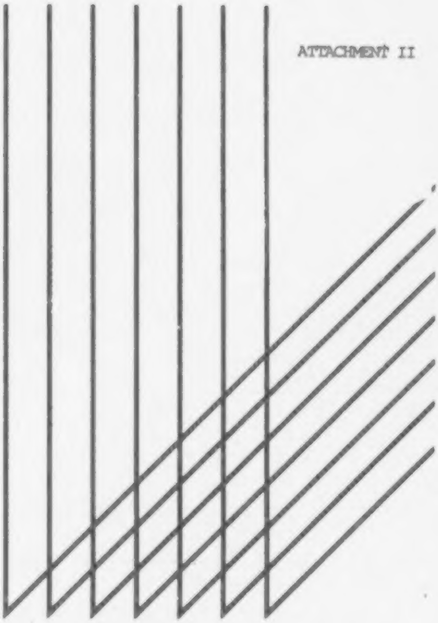
It must also be pointed out that mortgages are inappropriate investments for defined contribution plans. These plans, because of their need for frequent valuation require liquid highly marketable investments to permit rapid and precise valuation of accounts.

On reflection, Mr. Chairman, it appears from conversations with trust investment managers around the country that a need is being recognized. A new instrument must be developed which will attract institutional funds into residential mortgages without all the difficulties which must be encountered today. That instrument should have a high degree of liquidity, be of readily ascertainable value, offer certainty of the timing and amount of payment, and otherwise be operationally simple. We trust that the private sector, with the encouragement of government, has the ingenuity to develop this instrument.

Mr. Chairman, ABA is gravely concerned about proposals for mandating or allocating pension investments for social purposes. The ABA supports your effort to focus on impediments which serve to stifle the free flow of funds into important favored segments of the economy. We firmly believe that the fundamental standards contained in ERISA are sound. A fiduciary must carry out his responsibilities as would the "prudent man", under similar circumstances, "solely in the interests of the participants and beneficiaries". Further, the fiduciary must be ever mindful that the "exclusive purpose" of employee benefit plans, in the words of ERISA, is to provide "benefits to participants and their beneficiaries". The trustee, in choosing particular investments, must take into account all the present facts and circumstances and the prospects for the future. Additionally, ERISA requires that the investments be diversified so that the risk of loss is minimized. Thus, in picking the investments which make up a particular portfolio there is no built-in bias toward any particular type of security. The portfolio consists of a mix of securities chosen in such a way as to balance the level of risk of the portfolio in relation to the potential for income and capital appreciation. ERISA's prudent man rule allows for investment in all types of assets.

But ABA would most strongly oppose any effort to dilute the prudence standard or to mandate the allocation in any type of socially desirable investment whether it be residential mortgages or job creating. We agree with Congress' decision in ERISA that the provision of retirement benefits for our nation's retired workers is, in an of itself, a social goal of the highest order. We would stand firmly against any attempt to weaken the fundamental standards in ERISA to further social ends of the day.

ATTACHMENT II



The Future Of Bank Financial Services

For Income Property

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LENDING ON NONRESIDENTIAL REAL ESTATE IN THE 1980s

As our economy entered the 1980s, the constant dollar value of all new construction continued to decline from the 1978 total of almost $117 billion. By 1981, the value of new construction had fallen to $98.7 billion ($237 billion in actual dollars), and is expected to remain at about this level in 1982. Nonresidential construction has performed well in this depressed market, rising gradually in constant dollar value, 1980-1982, with office construction accounting for most of the increase.

As the economy recovers from the present recession, the increase in nonresidential real estate development is expected to be gradual through the mid-1980s, with any pronounced upswing in construction led by industrial and commercial developments. Although the Economic Recovery Tax Act of 1981 provided stimulus for investment in nonresidential real estate, the recent trend in contracting for new office space suggests that the latest office building cycle has peaked. The present underutilization of existing plant capacity and the dependence of much of commercial construction upon housing development indicate that, even in a recovering economy, the provision of new nonresidential real estate will proceed slowly into the mid-1980s.

The demand for nonresidential real estate will continue to vary markedly among regions in the 1980s with the South and West continuing rapid growth in population, income and economic strength, and the North growing more slowly. Within regions, small areas such as the East North Central, Mid-Atlantic and South Atlantic states are expected to experience significantly slower growth; the growth of other areas, such as the New England and West North Central states will accelerate. Within all regions, nonmetropolitan growth is expected to surge, suggesting that strong markets for nonresidential real estate will lie outside of the standard metropolitan statistical areas.

The rapid rise in interest rates in the late 1970s and the attendant high rate of inflation have resulted in notable changes in the ownership and financing of nonresidential real estate. The distinctions have blurred between owner and lender, and between sources of equity and sources of debt capital. Lenders increasingly have offered shorter-term loans with variable rates, equity participations and convertible features. With reluctance, developers surrendered to the lender a part, or all, of their traditional leveraged equity position. Developers have substituted increasing amounts of equity for debt, raising the equity by the syndication and selling of tax shelters or obtaining it from the lender. Pension funds and foreign investors have increased their acquisition of real estate, often purchasing new or seasoned properties outright or, to a lesser extent, engaging in a joint venture to develop the property. Foreign investors, however, remain a relatively minor factor in the market.

Pension funds are estimated to have about two percent of their assets in real estate equities. The enormity of their assets, $800 billion in 1981, and their expected growth in assets to $2.5 trillion by 1995, make pension funds potentially the most significant supplier of equity and debt capital to nonresidential real estate. Whether a predicted $20 billion increase in pension fund equity investments materializes by 1985 (Pension World), however, is uncertain as most pension funds continue to move relatively slowly into real estate.

Pension fund managers have begun to perceive real estate as offering protection against unanticipated inflation which erodes the real value of fixed-interest securities. The competition for prime real estate among pension funds and other investors has caused market prices to escalate, with investment real estate today selling for a very low overall capitalization rate. Nonresidential real estate has become a growth investment and is substituting in the lender's portfolio for an inflation-indexed security. An economy in which interest rates fall to a lower level and become more stable, could result in pension funds once again investing in bonds rather than real estate, resulting in a lesser rate of increase in the provision of equity funds from this source. Life insurance companies in the early 1980s should continue mainly to act as intermediaries for the pension funds in the supply of equity to nonresidential real estate through commingled real estate funds.

Commercial banks had assumed increasing importance in the declining market for nonresidential financing in 1981, supplying 44 percent of all long-term originations and more than 77 percent of the construction financing. Life insurance companies, savings associations and mutual savings, experiencing cash flow problems, reduced their shares of the market for long-term loans, and developers, sensing the potential for lower rates and less stringent terms, became increasingly reluctant to enter into financing arrangements which sacrifice the benefits of ownership. Commercial banks in 1981 provided interim financing for developers who either could not or preferred not to deal with alternative lenders.

Little change is forecast for the market share of nonresidential financing enjoyed by commercial banks as the economy moves into the 1980s. Commercial banks would obtain a larger share of the market in an inflationary economy with continued high interest rates, and should lose only a small portion of the market if inflation and interest rates abate and the economy begins to recover from the present recession.

Commercial banks may surrender a larger portion of the nonresidential financing market in the longer run if the economy does achieve lower and more stable rates of interest and a consistently lower rate of inflation. Lenders in this environment are expected to retain their protection against inflation and interest rate risk, achieved by the commercial banks with floating rates and by other lenders by participations. Developers, in this circumstance, would likely choose fixed rate, participating loans.

DEMAND FACTORS AFFECTING NEW NONRESIDENTIAL CONSTRUCTION

New Construction, 1972-1982

Table 1 shows the value of all new construction put in place, 1972-1982, in constant 1972 dollars. New construction totalled $124.5 million in 1972 and will have fallen to an estimated $99.9 million by 1982. The decline in the real dollar value new construction over the past three years can be attributed to the familiar litany of high interest rates, high and rising construction costs, a slow-down in the increase of the disposable income of households, and the general economic downturn.

Private residential construction accounted for 43.6 percent of the total value of new construction in 1972 and an estimated 31.6 percent of the total in 1982. Private nonresidential construction is expected to increase from 32.1 percent of total construction in 1972 to 42.3 percent in 1982. Public construction has fluctuated from about 21 to 26 percent of total construction, 1972-1982.

Nonresidential New Construction

Office buildings accounted for 13.2 percent of all private nonresidental construction in 1972 and will increase to about 21 percent by 1982. Industrial construction has fluctuated as a proportion of all private nonresidential construction from a low of 11.7 percent in 1972 to 18.1 percent in 1979, and is estimated at almost 16 percent in 1982. Other commercial construction, including shopping centers, retail, warehouses, etc., will fall from 20.5 percent of private

TABLE 1
VALUE OF NEW CONSTRUCTION
(Millions of 1972 dollars)

	1972		1977		1978		1979		1980		1981[a]		1982[a]	
	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total
Private Residential	$54,274	43.6	$50,511	45.5	$50,848	43.6	$47,617	41.4	$38,124	36.9	$35,200	35.8	$37,000	31.6
Private Non-Residential	39,965	32.1	35,760	32.2	39,329	33.7	42,929	37.3	40,722	39.4	41,600	42.1	42,300	42.3
Office	*5,288*	*13.2*	*3,584*	*10.0*	*3,976*	*10.1*	*4,906*	*11.4*	*6,126*	*15.0*	*7,600*	*18.3*	*8,800*	*20.8*
Other														
Commercial	*8,194*	*20.5*	*6,460*	*18.1*	*7,253*	*18.4*	*8,012*	*18.7*	*7,656*	*18.8*	*7,200*	*17.3*	*6,800*	*16.1*
Industrial	*4,675*	*11.7*	*5,242*	*14.7*	*6,629*	*16.9*	*7,790*	*18.1*	*6,374*	*15.7*	*7,100*	*17.1*	*6,700*	*15.8*
Other[b]	*21,808*	*54.6*	*20,474*	*57.2*	*21,471*	*54.6*	*22,*[illegible]	*51.8*	*20,566*	*50.5*	*19,700*	*52.7*	*20,000*	*47.3*
Public	30,259	24.3	24,768	22.3	26,512	22.1	24,556	21.3	24,553	23.7	21,900	22.1	26,060	26.1
Total New Construction	$124,498	100.0	$111,039	100.0	$116,689	100.0	$115,042	100.0	$103,399	100.0	$98,700	100.0	$99,000	100.0
Total New Construction Actual Dollars	$124,421		$173,829		$205,561		$230,781		$230,273		$237,000		-	

[a] Estimated by Bureau of Industrial Economics.

[b] Includes utilities, farm nonresidential, hospital and institutional, telephone and telegraph, religious, educational, railroad, pipelines, miscellaneous

Source: Gerald Moody, Abraham Goldblatt and Patrick MacAuley, Construction Review Nov./Dec. 1981. P. 4.

nonresidential construction in 1972 to 16 percent by 1982. The constant dollar value of office construction has risen steadily over the past ten years; the constant dollar value of industrial construction has remained relatively constant, 1977-1982; and the value of commercial construction has fallen. (Table 1)

Nonresidential construction typically follows the business cycle. The recession in 1975, for instance, was marked by the lowest constant dollar volume of nonresidential construction. Nonresidential construction also has fallen in the economic downturn of 1980-1982.

If the economy improves and interest rates decline, total private nonresidential construction is expected to increase significantly in the longer-run. After 1982, the increase will be aided by the accelerated cost recovery provisions of the 1981 Tax Act and by reduced business tax rates. One source forecasts total private nonresidential construction to increase from $42.3 billion to $61 billion in constant 1972 dollars by 1986, for a compound annual rate of increase of 8 percent, 1981-1986. (Moody, Goldblatt and MacAuley, Construction Review, Nov./Dec., 1981)

Office Buildings. After overbuilding in the early 1970's and a sharp decrease in construction in 1974-1976, office buildings have been developed at an increasing rate in the late 1970's and in 1980-1981. The ability to increase rents, particularly in major urban areas; the availability of equity participation financing; and the demand for ownership from pension funds and, to some extent, foreign investors, sustained the rate of construction. To a large extent, office construction in recent years reflects the post-war baby boom, individuals who are today's office workers. The increased levels of white collar service employment in the economy created a real need for additional office space.

In 1978, 200 million square feet of office space was contracted for, equalling a previous 1972 high. Contracted space increased to 244 million square feet by 1980 and to an annual rate of 300 million square feet by mid-1981. "The estimated 1982 total of 240 million square feet of contracting for offices, a 20 percent reduction from 1981's all-time peak, will consist of approximately 150 million square feet to satisfy newly created need, 76 million square feet to eliminate the remaining backlog of demand, and perhaps 15 million square feet of excess construction - the typical conclusion to office building cycles." (1982 Dodge/Sweet's Construction Outlook) Office markets may soften in Houston, Los Angeles, Miami, and Chicago, where space has been added rapidly. Smaller cities of 300,000 to one million population may remain relatively strong markets for office space. Office parks are doing well in several moderate-sized metropolitan areas. However, overbuilding of office space has been an historical fact in every type of market, and continuous monitoring of local demand, supply and absorption rates is a necessity for investors and lenders.

Commercial Construction. Commercial construction includes shopping centers, warehouses, parking garages, bank offices, restaurants, and other retail non-office developments. About one-half of commercial construction historically has been shopping centers. Shopping center construction has slowed markedly in the last few years, a victim of the slower rate of suburbanization resulting from rising fuel costs and the decline in new housing starts.

Shopping center/warehouse construction peaked in 1979 at 510 million square feet and declined to an estimated 320 million square feet in 1981. Shopping center developers have increasingly turned to renovation of existing centers and to the construction of smaller centers in unserved market areas, including smaller and medium sized cities. The large regional shopping mall, in particular, is in oversupply nationally.

Shopping center construction is not expected to increase until 1983 and future development of new centers will depend upon the rate of housing starts. Shopping center/warehouse construction follow housing cycles closely. If housing recovers, shopping center construction and aggregate commercial construction should increase gradually in the mid-1980's, reversing the continual decline in this type of construction since 1979. Other retail construction should be strong in the higher-income areas and in the discount or lower-priced retail outlets such as factory outlets, K-Mart, Gold Circle and similar establishments, and home improvement centers. Middle market retailing may be less active.

Shopping center and commercial renovation will be encouraged by the investment tax credits provided by 1981 Tax Act for rehabilitation of older commercial properties. The investment tax credits available for rehabilitation of older commercial real estate, combined with 15-year accelerated cost recovery, has significantly increased the profitability of rehabilitation. Rehabilitation of older commercial property, however, remains a relatively high risk venture due to cost overruns and the uncertainty of demand for the product, which may be less competitive than anticipated because of location or capacity to meet present needs, even after renovation.

Industrial Construction. Industrial construction is directly affected by business conditions, and a six percent decline in dollar volume is expected in 1982. As the economy recovers from the present recession, industrial construction will increase, although construction will lag the upturn until excess capacity is absorbed. At the present, the nation's manufacturers are operating at about 70 percent of capacity. Again, the recent tax legislation should encourage investment in industrial plants. If current federal policies do provide the stimulus to capital investment as intended, industrial construction could replace office buildings as the major impetus to private nonresidential construction. Contracts for industrial construction totalled 195 million square feet in 1981; in 1982, contracts may reach 215 million square feet; and by 1983, up to 250 million square feet is likely, surpassing the 1979 peak. Industrial construction is strong in high growth areas such as Phoenix, San Jose, Dallas and Houston. However, in some markets, the rent for industrial space has not kept pace with increases in construction costs and land prices, resulting in industrial parks accepting office and other uses.

Regional Differences

The national experience in commercial/industrial construction and forecasts of overall trends may differ markedly among regions and cities. The economic growth of the South and Southwest and of major energy producing states has produced marked increases in commercial/industrial development in those regions. The frost belt states, on the other hand, have fared less well and have been most affected by the present recession. The heavy concentrations of employment in basic industries and in consumer durables in many northeastern states have been severely affected by the decline in consumer demand, foreign competition, and the existence of older, obsolete plants. However, as the recession lengthens, its effects are being felt even in the sunbelt, with Arkansas and Alabama experiencing unemployment rates around 12 percent; Mississippi and Tennessee, about 10 percent; and Florida, Georgia and Louisiana, close to 8 percent. Major energy-producing states such as Texas and Colorado also are enduring the effects of the present oversupply of oil.

More attention is being given by investors to commercial/industrial development in markets outside of the major metropolitan areas such as New York, Washington, Los Angeles and Dallas, where prices have risen substantially, producing very low cash returns on investments. Second-tier metropolitan areas, such as Baltimore, Pittsburgh, St. Louis, Cincinnati, Columbus and others, and even smaller cities, can offer prime investment opportunities in income property and are expected to be of increasing interest to investors in the 1980s.

Table 2 provides the dollar volume of nonresidential, residential and public construction by regions in the United States; 1980-1982. Little change is noted for these years in the proportion of nonresidential construction among the four regions, with the South having 35 to 36 percent of all U.S. nonresidential construction; the West, around 24 percent; the Northeast from 17 to almost 19 percent; and the Midwest, 18 to 21 percent.

Growth of commercial and manufacturing construction, 1980-1982, has been most noticeable in the Northeast, which will increase an estimated 21.6 percent in dollar volume; followed by the South, 15.4 percent; the West, 11 percent; and the Midwest, only 1.5 percent.

Basic Determinants of Longer-Run Demand

In the longer run, commercial and industrial development in the several regions will depend upon the regional rates of population growth, employment and income. In an exhaustive analysis of regional growth trends, the Harvard-MIT Joint Center for Urban Studies takes issue with U.S. Census projections that suggest convergence among regions in growth rates. The Joint Center finds that patterns of regional divergence in the 1970s will continue through the 1980s. Regions with relatively low wage rates and a labor supply elastic enough to tolerate increased employment without driving up wages will continue to grow in population and per capita income. Regions unable

TABLE 2
VALUE OF NONRESIDENTIAL, RESIDENTIAL AND PUBLIC CONSTRUCTION
BY REGIONS AND U.S. TOTAL
1980, 1981 AND 1982
(millions of dollars)

NORTHEAST	1980	% U.S. Total	1981	% U.S. Total	1982[a]	% U.S. Total	Percent Change 1980-1982
Nonresidential							
Commercial and Manufacturing	$ 5,634	17.1%	$ 7,000	18.9%	$ 6,850	18.4%	21.6%
Institutional and Other	3,993	20.7	4,250	22.0	4,300	21.5	7.7
Total	$ 9,627	18.4	$ 11,250	20.0	$ 11,250	19.7	16.8
Residential							
One-Family	$ 5,752	13.9	$ 5,875	14.4	$ 8,550	14.8	48.6
Multi-Family	3,124	16.9	3,125	17.6	3,675	17.1	17.6
Nonhousekeeping	517	16.1	775	21.7	650	18.1	25.7
Total	$ 9,393	14.9	$ 9,775	15.7	$ 12,875	15.5	37.1
Public and Quasi-Public	$ 6,719	21.3	$ 4,875	16.6	$ 4,575	15.5	(31.9)
Northeast Total	$ 25,739	17.5	$ 25,900	17.5	$ 28,600	16.9	11.1
MIDWEST							
Nonresidential							
Commercial and Manufacturing	$ 7,045	21.3	$ 6,825	18.4	$ 7,150	19.25	1.5
Institutional and Other	4,658	24.1	4,375	22.6	4,425	22.2	(5.0)
Total	$ 11,703	22.6	$ 11,200	19.9	$ 11,575	20.3	(1.1)
Residential							
One-Family	$ 6,897	16.6	$ 6,050	14.8	$ 8,775	15.2	27.2
Multi-Family	3,059	16.5	2,850	16.1	3,350	15.6	9.5
Nonhousekeeping	443	13.8	550	15.4	550	15.4	24.2
Total	$ 10,399	16.5	$ 9,450	15.2	$ 12,625	15.2	21.4
Public and Quasi-Public	$ 6,437	20.4	$ 7,875	26.8	$ 7,675	26.0	19.2
Midwest Total	$ 28,539	19.4	$ 28,525	19.3	$ 31,875	18.8	11.7

TABLE 2 - CONTINUED

SOUTH	1980	% U.S. Total	1981	% U.S. Total	1982 a	% U.S. Total	Percent Change 1980-1982
Nonresidential							
Commercial and Manufacturing	$ 11,759	35.6%	$ 13,550	36.6%	$ 13,575	36.6%	15.4%
Institutional and Other	6,512	33.7	6,700	34.6	7,000	35.1	7.5
Total	$ 18,271	34.9	$ 20,250	35.9	$ 20,575	36.0	12.6
Residential							
One-Family	$ 17,854	43.0	$ 18,825	46.1	$ 26,400	45.7	47.9
Multi-Family	7,010	37.9	7,175	40.5	8,675	40.3	23.8
Nonhousekeeping	1,276	39.7	1,325	37.1	1,375	38.5	7.8
Total	$ 26,140	41.4	$ 27,325	44.0	$ 36,450	44.0	39.4
Public and Quasi-Public	$ 11,567	36.6	$ 9,700	33.0	$ 9,325	31.6	(19.4)
South Total	$ 55,978	38.0	$ 57,275	38.8	$ 66,350	39.2	18.5
WEST							
Nonresidential							
Commercial and Manufacturing	$ 8,603	26.0	$ 9,600	26.0	$ 9,550	25.6	11.0
Institutional and Other	4,141	21.5	4,025	20.8	4,225	21.2	2.0
Total	$ 12,744	24.3	$ 13,625	24.2	$ 13,775	24.1	8.1
Residential							
One-Family	$ 10,971	26.5	$ 10,075	24.7	$ 14,000	24.3	12.8
Multi-Family	5,326	28.8	4,550	25.7	5,825	27.1	9.4
Nonhousekeeping	977	30.4	925	25.9	1,050	29.4	7.5
Total	$ 17,274	27.3	$ 15,550	25.0	$ 20,875	25.2	12.1
Public and Quasi-Public	$ 6,890	21.8	$ 6,900	23.5	$ 7,925	26.9	15.0
West Total	$ 36,908	25.1	$ 36,075	24.4	$ 42,575	25.1	15.4

TABLE 2 - CONTINUED

U.S.TOTAL	1980	% U.S. Total	1981	% U.S. Total	1982[a]	% U.S. Total	Percent Change 1980-1982
Nonresidential							
Commercial and Manufacturing	$ 33,041	100.0	$ 36,975	100.0	$ 37,125	100.0	12.4%
Institutional and Other	19,304	100.0	19,350	100.0	19,950	100.0	3.4%
Total	$ 52,345	100.0	$ 56,325	100.0	$ 57,075	100.0	9.0
Residential							
One-Family	$ 41,474	100.0	$ 40,825	100.0	$ 57,725	100.0	39.2
Multi-Family	18,519	100.0	17,700	100.0	21,525	100.0	16.2
Nonhousekeeping	3,213	100.0	3,575	100.0	3,575	100.0	11.3
Total	$ 63,206	100.0	$ 62,100	100.0	$ 82,825	100.0	31.0
Public and Quasi-Public	$ 31,613	100.0	$ 29,350	100.0	$ 29,500	100.0	(6.7)
U.S. Total	$147,164	100.0	$147,775	100.0	$169,400	100.0	15.11

[a]Estimated

Source: McGraw-Hill Information Systems Company, 1982 Dodge/Sweet's Construction Outlook, 1981.

to attract or retain population, and with an inelastic labor supply and relatively high production costs will continue to suffer. The South and West will grow quickly, both in population and economic strength, and the North will grow slowly. However, within the North, the New England and West North Central regions will experience some resurgence, and the Pacific region in the West and the South Atlantic region in the South are expected to experience decelerating growth.

Table 3 compares U.S. Census projections of population growth by regions with the Joint Center projections. The significantly lower growth expected by the Joint Center for East North Central, Mid-Atlantic, and South Atlantic regions is evident from this table, as is the significantly greater growth expected for the West North Central, East South Central, Mountain and Pacific regions.

To a great extent, the growth patterns of population among regions will reflect migration of existing population among areas. Within regions, a resurgence of nonmetropolitan growth is expected outside of Standard Metropolitan Statistical Areas. Some portion of this growth will be a spillover from SMSAs, but nonmetropolitan growth also is attributed to the desire to avoid urban living, even at some loss of economic and cultural opportunities. (Joint Center, pp. 64-66) This pattern of growth suggests that commercial construction, which follows population, will be strong in less urban areas in the 1980s. Regions now benefitting from migration and rising population and income will continue to benefit for the remainder of the decade.

TABLE 3
PROJECTED PERCENTAGE POPULATION GROWTH BY REGION
U.S. CENSUS II-B AND JOINT CENTER PROJECTIONS
1980-1990

Region	Growth [a] (thousands)			
	Census II-B		Joint Center	
	Percent	Number	Percent	Number
New England	8.3	1,039	7.3	901
East North Central	4.5	1,868	-0.4	-166
West North Central	6.3	1,077	10.6	1,821
Mid-Atlantic	2.5	918	7.6	2,795
South Atlantic	16.9	6,188	9.6	3,547
East South Central	10.0	1,416	24.5	3,593
West South Central	13.7	3,051	25.3	6,007
Mountain	20.7	2,220	31.9	3,627
Pacific	12.0	3,572	16.4	5,215
Total U.S.	9.6	21,353	9.6	21,750

[a] Growth rates use 1980 as base.

New England: Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut; East North Central: Ohio, Indiana, Illinois, Michigan, Wisconsin; West North Central: Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, Kansas; Mid-Atlantic: New York, New Jersey, Pennsylvania; South Atlantic: Delaware, Maryland, District of Columbia, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida; East South Central: Kentucky Tennessee, Alabama, Mississippi; West South Central: Arkansas, Louisiana, Oklahoma, Texas; Mountain: Montana, Idaho, Wyoming, Colorado, New Mexico, Arizona, Utah, Nevada; Pacific: Washington, Oregon, California, Alaska, Hawaii.

Source: Gregory Jackson, et al., Regional Diversity: Growth in the United States, 1960-1990, Boston: Auburn House, 1981, pg. 62.

SOURCES OF EQUITY IN THE 1980s

Pension Funds

The most significant development in the provision of equity capital for commercial/industrial real estate has been the increased interest of pension funds in real estate investment. The potential of pension funds both as a source of equity and mortgage financing is staggering. In 1981, there were 500,000 private pension funds, 6,600 state and local funds, and 38 federal funds, with combined assets of $800 billion. By 1995, pension fund assets are expected to increase to $2.5 trillion.

Pension funds are estimated to have about two percent of their assets in real estate equities. One source predicts that pension funds will increase real estate equity investment by $20 billion by 1985. Of the $20 billion increase, $13 billion will come from private pension funds and $7 billion from state and local funds. (Pension World, September 1981)

The increased interest of pension fund managers in real estate equities is attributable to several factors:

(1) An interpretation of the Employee's Retirement Income Security Act of 1974 (ERISA) to favor diversification of pension fund investment portfolios. Fund trustees also are to follow the prudent man rule, and to invest the assets of the fund as a knowledgable prudent man, which can be interpreted as seeking the highest yields attainable at a reasonable level of risk.

(2) Dissimilarities in the real estate and securities market decrease the covariance of year-to-year returns from real estate investments and from stocks and bonds, permitting the proportion of real estate equity investments to increase in the portfolio and still attain an acceptable level of risk or variance in the portfolio return.

(3) The use of commingled real estate funds (CREFs) managed by insurance companies, commercial banks, and certain investment houses, provide a mechanism for obtaining diversified investments in real estate equities. CREFs permit diversification by property type and by geographic area. A large CREF may accomplish both types of diversification, or the pension fund manager may purchase shares in a number of funds which specialize in property types or regions.

(4) The stability of real estate values relative to marked values of stocks and bonds, which are reflected significantly by a change in the level of interest rates and stock market conditions. As a point of illustration, the market value of the investment portfolio of the Federal Reserve System pension plan, invested in securities, declined $30 million or about 7 percent in 1981. Real estate values are markedly less volatile.

(5) The potential of a relatively high rate of return. The combination of expected annual appreciation in market value and net cash returns produces a substantial yield on real estate equity investments. Pension fund managers, when asked to provide the minimum acceptable net cash yield (unlevered) from real estate equity investments, responded:

Minimum acceptable net cash rate of return	PROPORTIONS OF PENSION FUND MANAGERS RESPONDING				
	1975	1976	1977	1980	1981
7%	5%	17%	21%	11%	18%
8%	20%	15%	18%	13%	20%
9%	22%	15%	17%	14%	11%
10%	17%	21%	17%	17%	19%
Over 10%	13%	13%	9%	21%	26%
No response	23%	19%	18%	24%	6%

Source: Pension World, Sept., 1981. 205 responding from survey of 1,200 largest funds.

In 1981, 45% of the pension fund managers responding required a 10% or greater net cash return on real estate equities. This return does not include potential appreciation in the value of the property. Minimum expectations for annual appreciation were:

Minimum annual appreciation	1975	1976	1977	1980	1981
2%	23%	12%	9%	3%	1%
3%	26%	18%	12%	4%	5%
4%	16%	9%	6%	6%	8%
4%+	17%	37%	48%	66%	70%
6%+	-	-	-	-	46%
8%	-	-	-	-	32%
No response	14%	23%	21%	21%	14%

Inflation expectations are very evident in these responses over time. By 1981, 46 percent of pension fund managers expected a minimum annual rate of appreciation in value of 6% or more.

(6) The potential of real estate as an inflation hedge, particularly in view of the stock and bond experiences in the 1970s. Tempering this expectation are the substantial rent increases in certain markets in recent years, such as the markets for prime office space in major cities. The ability of commercial/industrial tenants to pass rent increases on to customer is facilitated by the indexed lease and the requirement that tenants share volatile operating expenses. However, the risk of saturated local markets must be considered in forecasts of continuing rent increases.

(7) The ability to structure the ownership position to further diversify the investment portfolio. The pension fund may purchase the property outright; joint venture a development; buy into a limited partnership; engage in a purchase-leaseback; or invest in a commingled fund. About 43 percent of pension funds intending to purchase new real estate equities in the next three years intend to use commingled funds; 18 percent anticipate direct ownership; limited and general partnerships and other ownership forms are much less often used.

(8) Greater operating control over the investment can be exercised by the pension fund manager, if desired. Real estate is a management intensive investment and net income and market value can be influenced by

management policies for maintenance and repair, rehabilitation and expansion. The use of commingled funds removes the pension fund from active management, which may be preferable if the fund lacks internal expertise.

(9) Only real estate markets are large enough to absorb the volume of money pension funds have to invest.

Factors which would reduce the incentive of pension funds to invest in real estate equities include:

(1) The relative illiquidity of real estate investments; however, the liquidity needs of pension funds are low, with most pension plans able to meet current benefits from annual contributions, leaving the fund itself intact for long periods of time. Commingled funds also provide a measure of liquidity not available in direct ownership of large real estate investments.

(2) The expertise needed to find suitable properties, to negotiate their purchase, and to manage the property may not be available in-house. Developing such capabilities represent a significant front-end expense for the fund. Expert assistance for direct investment is available from consulting firms and commingled funds, of course, contend that such capabilities are one of their principal advantages.

(3) Public pension funds may be restricted to investing in their state, or "social investing" may result from political pressure to invest locally.

(4) A perceived long-term reduction in the rate of inflation, accompanied by lower and more stable interest rates, which would favorably affect the market value of the fund's portfolio of securities, may result in real estate equities again being the least-favored investment. Indexing the returns on debt instruments to alleviate interest-rate risk and the effect of anticipated inflation also could reduce the interest of pension fund managers in real estate equities.

(5) The availability of large-scale, prime, "investment quality" real estate projects ultimately will determine the magnitude of pension fund investment in real estate equities and mortgages. Already, pension fund managers are decrying the lack of quality investment properties.

Although pension funds invest in a variety of real estate, including raw land, agricultural land, shopping centers, detached retail, industrial parks and single industrial properties, warehouses, and hotels, they have historically been a major purchaser of office buildings, with a preference for large buildings in the central city. A Pension World survey of 25 corporate funds and eight government funds found that direct ownership of office buildings accounted for 21 percent of the total real estate equities in these funds. Shopping centers accounted for 19 percent of total real estate equities; warehouses, 13 percent; industrial, 9 percent; apartments, 4 percent; hotels, 2 percent; farms, 7 percent.

Almost one-third of direct investment in real estate equities in the next three years is anticipated to be in office buildings. Another survey of major commingled funds managed by insurance companies and commercial banks showed 30.2 percent of their total investments in office buildings; 29.5 percent in industrial, including warehouses and office/warehouse; and 24.7 percent in commercial, including shopping centers, retail and department stores. (Estey and Miles, Commercial and Investment Journal, Vol. 1, 1982.)

The sheer volume of potential equity funds available from pension funds overwhelm the availability of new prime real estate developments. Suggestions of counselors are appearing which encourage the purchase of older, "quality" properties; to engage in development as well as in the purchase of new property; and which tout the smaller, non-urban, "second-and-third-tier" markets as a source of equity investments. Such advice may result in higher yields, but at a higher level of risk in the portfolio.

Insurance Companies

Insurance companies, with a steady inflow of premium dollars from whole life policies, were formerly the largest provider of capital to commercial real estate. However, the recent high levels of interest rates resulted in the savings aspect of whole life becoming less attractive to consumers, who began to purchase greater amounts of term insurance, affecting the reserves available to the insurance industry for long-term investments. Insurance companies have been diversifying the products offered to the consumer. For instance, the universal life policy, which combines insurance with a money market fund, Independent Retirement Accounts, and Keough Plans are being tentatively offered. Ultimately, these plans and others may raise significant amounts of capital for the industry which may not initially, but which may over time, go into real estate equities or financing.

Some insurance companies, such as Prudential, Equitable and Connecticut General, have for some time invested in or developed real estate for their own account and joint ventured with real estate developers. As insurance company reserves available for long-term investment for their own general accounts have suffered, the industry has moved toward becoming money managers for others, particularly pension funds through separate account commingled funds. These funds range from large open-end pools offered by Prudential, Equitable, Aetna, John Hancock and others, to smaller closed-end funds. The closed-end fund raises a given amount of capital and is closed to additional investors. The participation of an investor is for a fixed time period, usually seven to twelve years. Typically, there is no penalty for withdrawal of funds, but the investor may have to find a buyer. The open-end fund is more liquid, with units generally redeemable at the end of each quarter with advance notice. Commingled funds have become a favorite vehicle for pension funds seeking to diversify into real estate.

The asset value of commingled equity real estate funds at the end of 1980 was $6.3 billion, increasing from $3.5 billion in 1979 (includes both bank and insurance company funds). The growth of these funds has been rapid, from $750 million in 1974 to $6.3 billion in 1980. Future growth is difficult to predict and will depend upon the willingness of pension funds to use CREFs for real estate investments. Insurance company-managed commingled funds are significantly larger than bank-managed funds. The median insurance fund was $352.7 million in 1980; the median bank was $64.8 million.

A survey of commingled funds managed by Aetna, Equitable, Hancock, Metropolitan, Prudential (two funds) and Travelers indicates the diversity of their investments. Although certain funds may specialize, the large insurance funds show reasonable diversity on average, with office buildings and commercial real estate each accounting for about one-fourth of their aggregate portfolio. (Table 4)

TABLE 4
INVESTMENT BY PROPERTY TYPE
INSURANCE CREFs

	Maximum Percent	Median Percent
Cash	46.1%	16.1%
Real Estate	97.3	82.1
Hotels, Motels	100.0	12.8
Industrial Warehouse	50.1	15.8
Land, land lease	1.6	0.0
Office	68.2	24.9
Residential apartment	9.9	0.0
Commercial	54.0	24.0
Agriculture	9.3	1.4

Source: Estey & Miles, "How Pension Funds Invest Through CREFs," Commercial Investment Journal, Vol. 1, 1982, pp. 8-15.

The large-open end funds of insurance companies facilitate large single investments although CREF managers differ in their philosophy concerning the size of investments. Some fund managers contend that a $50 million shopping center can be as easily analyzed and acquired as a $3 million center; others contend that properties in the $2.5 million to $15 million range are optimum, being above the reach of the tax-motivated individual, but below the keen competition among the large CREFs in the market for $50 to $100 million properties.

An indication of the profitability and stability of rates of return in these commingled funds is illustrated by comparison of three funds with indices for stocks, bonds, treasury bills and the consumer price index. The CREFs demonstrated a significantly higher rate of return over time and a lower variation of yields. (Table 5)

TABLE 5
ANNUAL RATES OF RETURN
CREFs, STOCKS, BONDS, TREASURY BILLS, CPI

Market indices	1 year (1979)	3-Year Average (1977-79)	5-Year Average (1970-74)	5-Year Average (1975-79)	10-Year Average (1970-79)	10-Year Standard Deviation
Real Estate Fund Index[1]	21.6%	15.0%	8.4%	12.2%	10.3%	4.9%
Standard & Poor's 500 Stock Index	17.4	5.0	-4.2	14.5	4.7	19.6
Salomon Brothers Long-Term Corporate Bond Index	-4.9	-1.1	5.6	5.6	5.6	8.0
90-Day Treasury Bills	9.8	7.4	6.0	6.6	6.3	1.8
Consumer Price Index (C.P.I.)	13.3	9.7	6.6	8.2	7.4	3.4

[1] A composite performance of PRISA, Equitable, & First Chicago commingled funds.

Source: Brachman, "Rating Commingled Funds," Pension World, September 1981.

CREFs traditionally have purchased new and seasoned properties, although some funds have always developed some real estate. It is expected that CREFs, as a whole, will increasingly purchase leveraged properties and will engage in development to a greater extent in the future.

Foreign Investors, Corporations, Individuals and Others

Foreign investors are increasingly purchasing commercial/industrial properties in the United States. The foreign investor has been interested in all types of commercial property and a variety of separate deals are continuously reported: British Airways pension fund: office buildings in Evansville, New Orleans, and Florida, shopping centers in Houston and Virginia for a total investment of $44.8 million; the Imperial Group Fund (U.K. American Properties Fund (representing 33 commingled funds): total U.S. real estate investments of $300 million; British National Coal Pension Fund, purchasing a $350 million REIT from Continental Illinois Bank, with additional commitments of $50 to $70 million per year to buy U.S. commercial property; Morgan-Stanley in 1981 had deals with two Japanese insurance companies, a Hong Kong hotel investor, a Saudi Arabian prince, a Kuwaitian, and a British pension fund, with one-third of their 1981 business being with offshore investors. Generally, these foreign investors are seeking the same type of property that other major suppliers of equity capital seek, i.e., office buildings, shopping centers, warehouses, industrial projects and land. Estimates of total foreign investment in U.S. commercial/industrial real estate range from $5 to $10 billion.

Equity capital continues to be supplied through investments by real estate limited partnerships and direct ownership by individuals seeking tax-sheltered income. The 1981 Tax Act created conflicting incentives for high tax-bracket investors. The accelerated cost recovery system permitting a 15-year writeoff of depreciation, with the option of using 175 percent of the straight-line rate, increased the tax shelter opportunities in investment real estate, as did the investment tax credits for rehabilitation of older commercial/industrial real estate. On the other hand, the reduction of the maximum ordinary tax rate to 50 percent reduces incentive to seek tax sheltered investments. The net effect of these contradictory influences on the flow of equity capital into real estate tax shelters is yet to be ascertained.

Other suppliers of real estate equity are corporations, which are beginning to realize that their plant and other real estate holdings may yield more profit than the business conducted therein. Mortgage bankers, to a limited extent, are putting equity into new developments for which they arrange financing, with the developer and lender each giving up some part of their positions. An equity position by a mortgage banker of, say, ten percent, may be encouraged by the lender, who feels that protection in the deal is increased if the mortgage banker is a partner. If the mortgage company is owned by a commercial bank, it cannot take an ownership position. Money market mutual funds, which are anticipated to grow to $200 billion, are being mentioned as potential suppliers of real estate equity and mortgage funds. The service corporations of the thrift industry have their activities limited to those "reasonably related" to the activities of the parent associations, which are restricted to investing no more than three percent of their assets in service corporations. Service corporations have purchased or developed investment real estate, although neither they nor their parent associations have been a major source of equity for commercial/industrial real estate.

SUPPLIERS OF MORTGAGE LOANS IN THE 1980s

Trends in Long-term Financing

Commercial banks in 1981 recaptured a portion of the market for long-term nonresidential financing which had been increasingly served since 1977 by life insurance companies and mortgage bankers. Of the total $32.2 billion in nonresidential long-term originations in 1981, commercial banks obtained $14.2 billion or 44.2 percent, the largest share since the 49.1 percent obtained in 1977. (Table 6) Commercial banks increased both the dollar volume of long-term originations and market share in 1981; the dollar volumes and shares of market for all other sources declined. Life insurance companies originated $9.7 billion in long-term nonresidential loans in 1981 for a 30 percent share cf the market; in 1980, life insurance companies accounted for $11.1 billion and 31.5 percent of the market. Mortgage bankers also experienced a decreasing dollar volume and market share, falling from $4.6 billion in 1980 to $2.4 billion in 1981, and from 13.1 percent to 7.4 percent of the market.

Savings associations and mutual savings banks continued to supply lesser amounts of long-term nonresidential loans, falling from $5.2 billion in 1980 to $4.2 billion in 1981, a trend which has continued since 1977, when these institutions together supplied $7.6 billion in originations and accounted for 21.3 percent of the market. Savings association regulations on commercial property lending were liberalized in 1980. Associations may now place 20 percent of their assets

TABLE 6
NONRESIDENTIAL
LONG TERM ORIGINATIONS
BY TYPE OF LENDER
(Dollars in Billions)

Year	Total	%	Commercial Bank Amount	%	Mutual Savings Banks Amount	%	Savings Assoc. Amount		Life Ins. Co. Amount		Mortgage Bankers Amount		Others[a] Amount	%
1973	$26.7	100.0%	$11.5	43.0%	$ 2.5	9.3%	$ 4.0	15.1%	$ 6.3	23.7%	NA	NA	$ 2.4	8.9%
1974	22.8	100.0	8.7	38.1	1.7	7.3	3.6	15.8	6.4	28.3	.8	3.5	1.6	7.0
1975	22.7	100.0	8.6	38.1	1.3	5.9	4.9	21.6	5.7	25.3	1.1	4.8	1.1	4.2
1976	25.0	100.0	10.3	41.3	1.7	6.9	5.0	20.0	6.0	23.9	1.1	4.2	.9	3.7
1977	35.5	100.0	17.3	49.1	1.7	4.7	5.9	16.6	8.0	22.5	1.5	4.1	1.1	3.1
1978	42.7	100.0	17.5	41.1	1.7	4.0	5.3	12.4	10.0	23.4	6.5	15.3	1.7	3.9
1979	40.6	100.0	16.4	40.5	1.2	3.0	4.5	11.1	10.9	26.8	6.1	15.0	1.5	3.6
1980	35.1	100.0	12.4	35.5	1.0	2.9	4.2	11.9	11.1	31.5	4.6	13.1	1.8	5.0
1981	32.2	100.0	14.2	44.2	0.6	2.0	3.6	11.3	9.7	30.0	2.4	7.4	1.6	5.1

[a] Includes REITS, state and local and others.

Source: HUD, Gross Mortgage Flows; Thomas J. Parliament, "Real Estate Finance," U.S. Savings & Loan News, Sept., 1981; 1981 updates supplied by U.S. Savings & Loan League.

in nonresidential loans and the loan to value ratios have been increased from 75 to 90 percent. The loan to value ratios for unamortized, interest-only loans were increased from 60 to 75 percent for loans up to five years maturity, and five-year construction loans can be made. The thrift industry, however, has been slow to exercise their new lending capacities as associations struggle with low savings inflows and liquidity problems. Nevertheless, the industry is now better positioned to compete as a nonresidential lender when more pressing problems are alleviated.

The increased shares of the long-term nonresidential market captured by life insurance companies and mortgage bankers during the recent period of high rates of inflation can be attributed to the ability of these lenders to structure equity participations, joint ventures, syndications and other arrangements in order to continue to supply funds to hard-pressed borrowers. Commercial banks, on the other hand, have been unable to provide many of the innovative financing and co-ownership arrangements. In many instances, these borrowers were asked to surrender substantial amounts of their equity positions. As the present recession lengthened into 1981, the demand for nonresidential loans continued to drift downward. Borrowers increasingly turned to commercial banks for their long-term financing as life insurance companies, experiencing cash flow problems, backed away from the long-term market. Another view of the shift to commercial banks speculates that borrowers are increasingly willing to take the floating and indexed rates offered by commercial banks, anticipating an increased ability to refinance at more favorable terms. If borrowers are anticipating lower interest rates and easier credit, they will turn away from the equity participation arrangements which require surrendering benefits of ownership to the lender. Construction loans originated by commercial banks may be stretched out past the 24 to 36 month construction period while borrowers search for more advantageous terms.

The changes in commercial real estate loan originations among lenders affect the relative proportions of mortgage debt held (Table 7). Total commercial mortgage debt has increased almost two and one-half times since 1972. The share of commercial mortgage debt held by commercial banks has remained relatively constant since 1978 at around 31-33 percent. The share held by life insurance companies has increased continuously since 1978 from 29.4 to 31.9 percent in 1981. The proportion held by mortgage banking companies, noninsured pension funds and others increased by more than 2 percent in 1981, to 14.8 percent. The increased share of commercial mortgage debt held by insurance companies, mortgage bankers and others came from reductions in the holdings of mutual savings banks and savings associations, which together experienced a decrease of almost 5 percent in commercial mortgage debt held, 1979-1981.

Trends in Construction Financing

Construction loans since 1973 have been increasingly supplied by commercial banks, which accounted for 57 percent of construction financing in 1973 and 77.2 percent by 1981. (Table 8) Real estate investment trusts ceased to be a factor in construction financing in recent years, permitting commercial banks to participate to a greater extent in this market. The proportions of this market

TABLE 7
COMMERCIAL REAL ESTATE MORTGAGE DEBT BY TYPE OF HOLDER
(Dollars in Billions)

Year	Total	%	Commercial Banks		Mutual Banks		Savings and Loans		Life Ins. Co.		Others[a]	
			Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1972	112.3	100.0	$31.7	28.2%	$10.3	9.2%	$18.7	16.6%	$31.6	28.1%	$20.0	17.8%
1975	159.3	100.0	46.9	29.4	13.4	8.4	29.1	18.3	45.2	28.4	24.7	15.5
1978	211.9	100.0	66.1	31.2	16.3	7.7	40.5	18.2	62.2	29.4	26.8	12.6
1979	236.5	100.0	76.0	32.1	17.0	7.2	43.8	18.5	71.1	30.1	28.6	12.1
1980	256.5	100.0	81.1	31.6	17.1	6.7	45.3	17.7	80.7	31.5	32.3	12.6
1981	279.1	100.0	90.9	32.6	17.2	6.2	40.7	14.6	89.0	31.9	41.3	14.8

[a] Other holders include Farmers Home Administration, mortgage companies, uninsured pension funds, credit unions, a real estate investment trust.

Source: Federal Reserve Bulletin

TABLE 8
NONRESIDENTIAL
CONSTRUCTION LOANS
BY TYPE OF LENDER
(Dollars in Billions)

			Commercial Bank		Mutual Savings Banks		Savings Assoc.		Life Ins. Co.		Mort. Bankers		Others[a]	
Year	Total	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1973	$12.4	100.0%	$ 7.0	56.6%	$ .4	3.2%	$1.8	14.3%	$ .2	1.7%	NA	NA	$3.0	24.1%
1974	15.2	100.0	9.6	63.5	.3	1.7	1.4	9.0	.2	1.4	1.4	9.1	2.3	15.4
1975	10.1	100.0	5.5	54.1	.2	1.8	1.8	17.5	.3	3.4	1.1	10.5	1.2	12.1
1976	11.8	100.0	7.8	65.7	.2	2.0	2.1	17.8	.3	2.6	.8	6.7	.6	5.1
1977	12.7	100.0	7.9	62.7	.4	2.8	2.3	18.1	.5	4.2	1.0	7.6	.6	4.5
1978	18.2	100.0	12.8	70.2	.5	2.6	2.2	12.1	.3	1.8	1.6	8.7	.8	4.6
1979	23.0	100.0	16.8	72.9	.5	2.0	2.1	9.3	.5	2.3	2.4	10.5	.7	2.9
1980	23.6	100.0	17.3	73.2	.5	2.3	2.0	8.6	.7	2.9	2.3	9.6	.8	3.4
1981	25.8	100.0	19.9	77.2	.6	2.4	2.3	8.9	.7	2.6	1.9	7.3	.4	1.6

[a] Includes REITs, state and local, and others.

Source: HUD, Gross Mortgage Flows: Thomas J. Parliament, "Real Estate Finance," U.S. Savings & Loan News, Sept., 1981; 1981 updates supplied by U.S. Savings & Loan League.

served by mutual savings banks and savings associations also have trended downward since 1977. By 1981, these institutions originated only 11.3 percent of construction loans. Mortgage bankers are credited with 7.3 percent of the market in 1981, down from 10.5 percent in 1979. Life insurance companies have had a relatively stable percentage of the market in the last three years, ranging from 2.3 to 2.9 percent.

Financing Arrangements in the 1980s

Lenders today are engaging in a variety of debt/equity financing arrangements for nonresidential real estate. While every aspect of the deal is negotiable, the bargaining between developer and lender generally focuses on the combination of expected cash flow, including participations, and reversion value which provides an 18-20 percent internal rate of return to the lender.

Some examples of financing arrangements in the past three years are:

> Equity participations. Below market nominal rate with or without points, amortization up to 30 years with a balloon in 5-10 years; percentage of effective gross income over pro forma or of net income as participation; may also have right to share in cash reversion of refinancing.
>
> Sale of site to lender, leaseback with leasehold mortgage. Lender purchases site at market value and leases back to developer under long-term ground lease with renewal options; site rent is at mortgage interest rate; leasehold mortgage with 30-year amortization, 15-year call option, below-market interest rate, may have participation in cash flow and sales proceeds over amount of mortgage loan and ground investment.

Purchaser-sell back. Lender buys site and improvements for less than cost and sells back to the investor on 30-40 year installment contract at or below market interest rate; lender also may participate in cash flow after operating expenses and installment payment, operating expenses not to exceed stated maximums; buyer under installment contract may acquire title by payment in full of outstanding balance of the contract with prepayment penalties that are reduced over time.

Joint venture. Diverse arrangements for division of ownership, cash flow, and proceeds from sale are possible. An example: the developer puts the land into the joint venture at market value and the lender puts up the entire cost of improvements. Net income is split as follows: First, a preferred and cumulative return to the lender on funds invested at a rate near the market interest rate; Second, to the developer on value of site at same rate; then, any remainder split equally between lender and developer. In the event of sale of the property, proceeds first pay off the funds advanced by the lender; the remainder is paid to the investor.

Wraparound. Second mortgage is wrapped around existing first mortgage; lender advances only difference between new mortgage and balance outstanding on existing mortgage and levers the yield on the wraparound on the lower interest rate of the existing mortgage.

Standby equity. Lender wants to fund the equity but not the debt. An interest rate and mortgage term are selected which are likely to be available in three to five years. A loan is made at 70 percent of project cost as a fundable standby, with interest only for 3-5 years. Lender provides the equity for a below-market preferred and cumulative return. Project is owned 50-50 with the developer; tax writeoffs from construction are shared. Or, in another version, the lender gets all cash flow after a stated return to the developer until the equity investment is returned; then cash flow is split evenly between lender and developer.

Lender provides debt and equity. Net operating income is divided by the minimum debt coverage ratio to obtain income available to service the mortgage; mortgage constant for 30-year term is used to determine the amount of the loan; lender also provides balance of project value as equity contribution. Lender receives preferred return on equity, debt service on mortgage, and 50 percent of any remaining cash flow.

Construction and long-term combinations. A variable rate, fixed payment loan, with a construction loan at a floating rate, and a five-year interim takeout loan at end of construction. Interim loan is below market, 30-year amortization, with fixed debt service and a balloon in five years. The developer also must pay the difference each year between the floating construction loan rate and the rate on the interim loan. If the developer owes the bank at end of each year, the additional interest can be paid in cash, added to the principal owed if the loan to value ratio warrants, or the mortgage constant on the five-year loan be increased.

Another version accrues interest on a five-to eight year floating rate loan made at end of 24-month construction loan; accrued interest above fixed constant is added to balance of loan unless the debt service coverage falls below 1.20, then accrued interest must be paid.

Lender provides 24-month loan for all of project cost, except for developer's fee at fixed rate; at the end of 24 months, the loan is converted to equity with lender receiving preference to obtain stated below-market return on investment; balance of pro forma net income goes to developer; increases over pro forma split between lender and developer, with lender receiving proportion necessary to obtain required yield.

Construction loans. Banks are making open-end, floating rate, up to 36 months; loans may or may not require take-out commitment.

Commercial banks are extending these loans on 12 months options for 1 to 2 points; some banks will reduce interest and accrue the difference; others give 3 to 5 standby takeouts with floating rates and 1 to 4 points, with some interest deferred.

Convertible mortgage. Loan is made at 80 percent of value for five years at below-market interest only; the sixth's years net income is projected and capitalized to set value. Lender has sole option to purchase 50 percent ownership position at 5 to 10 percent of sixth-year value.

Office building under construction with first mortgage committed; additional funds needed for completion. Lender gave second mortgage at below-market rate, receiving 50 percent of all gross revenues over fixed costs of building. At end of 10 years, second mortgage is convertible into a 75 percent equity position, with lender having option to buy the 25 percent at current market value.

Lender gives 75 percent financing at below-market rate, usually interest only for a five year term. At an agreed upon time, the lender exercises his sole option to purchase the property at an amount related to the outstanding balance of the loan; developer takes depreciation writeoffs while owning the property and receives 75 percent of the value of project upon completion and rent-up, paying no tax on these "refinancing" proceeds.

Bullet loans. Three to eight-year fixed rate loan, interest only, sometimes with partial amortization; usually borrower is locked in with a penalty for prepayment to give equivalent yield for remaining term of loan; no participation; callable at end of fifth-seventh year; for each year beyond fifth, a fifty basis point premium may be charged over the initial fixed rate; underwriting with a 1.20 debt service coverage. Often used to refinance seasoned property with considerable equity or to get off a construction loan.

Pre-sale to institution. Forward equity commitment by life insurance company on prime project; maximum funding advanced upon 80-95% lease-ups; less than 50-80% lease-up, funding may cover only builder's cost and overhead and could result in no sale. Several variations exist, but protect the lender in the event of lack of demand for the project. Some sales are only for 70% of equity to keep developer in for property management.

Fixed-rate takeouts. Small life insurance companies and smaller pension funds make high fixed rate loans; 60-65% loan to value, call dates of 5-10 years, amortized over 25-30 years rate increase and/or fee for extension. Savings associations may lend at below market plus 2-3 points in fees, and 30% equity for 3 year loan and 50% for 8 year loan.

Second mortgages. Floating rates 1½-2½% over prime with 1 point fee and 3-5 year term; no participation; 1.10 debt coverage ratio on seasoned properties with fixed rate first mortgages. Convertible second mortgages at below market interest only with participation of 25% to 40%, borrower has fixed rate first mortgage without participation.

Interest-free mortgage. Where this is an owner-user, such as an office condominium; loan for 85% of cost, 32 percent down, and five year full amortization.

Public and Private Financing combinations. Urban Development Action Grants used for commercial and industrial development in "distressed cities" which have a fair housing plan and promote equal opportunity in employment and housing. City obtains federal grant and makes a second mortgage loan to the developer, when city is repaid the money can be reused locally; interest rate about the same as tax-free industrial revenue bond rate; terms are flexible (interest only; partial amortization; deferred interest; city may participate in cash flow). The future of the program is uncertain; UDAG is funded this year, but may be phased down beginning in 1983.

Industrial Revenue (Development) Bonds issued by a state, county or municipality for project which creates or preserves employment. Project is either owned by the government and leased to the user who has option to buy at end of lease; owned by government and sold to user on installment sale; or a loan is made to the user-owner; terms up to 30 years at tax free interest rate; may be combined with conventional financing. Commercial banks may give a letter of credit to experienced developer; investment house sells bonds with bank as security if project does not generate sufficient net income to service bonds.

Bonds are retired by user and may be privately placed with a lender who also has participation, or underwritten publically. Limited in amount to $10 million to obtain Federal tax exemption for interest; can be combined with UDAG to spend $20 million within the issuing governmental jurisdiction. The Internal Revenue Service is studying the purpose for which industrial revenue bonds have been issued and Congress may restrict their use. At the present, institutional investors have had a surefeit of tax-exempt issues, with the result that the interest rates from these instruments are close to market.

SBA 503 program permits a fixed-rate second mortgage at below market rates if project will increase employment; developer puts in 10%; bank will make a 50% first mortgage with floating rate and 10-15 year balloon.

Lending in the Mid-1980s.

The magnitude of the market for nonresidential financing in the mid-1980s will depend upon our rate of recovery from the present recession. The recovery would be slowed if high interest rates and inflationary expectations persist. Continuing high interest rates also would result in greater proportions of equity substituted for debt in financing nonresidential real estate. In this scenario, total nonresidential loan demand would fall to less than the 1981 level of $58 billion. Nor would aggregate nonresidential loan demand be expected to increase significantly as we move into the mid-1980s.

In this situation, commercial banks should experience a small increase in their present share of long-term nonresidential lending and would continue to obtain a high proportion of construction financing. The increased share of the market obtained by commercial banks would come primarily from the market shares of savings associations and mutual savings banks; life insurance companies and mortgage bankers would retain relatively stable market shares.

Recent abatement in the rate of inflation, a current slackening demand for loans, and an election year, combine to suggest that the level of interest rates will moderate in 1982. The ability to reduce and to keep interest rates at a lower level would in large part depend upon control of the potentially huge federal deficit and, over the longer run, upon a reduction of inflationary expectations.

Even with a scenario of lower long-term interest rates in the 13-14 percent range, the aggregate market for nonresidential financing should increase only gradually. Any significant increase in demand based upon economic need for nonresidential property must wait until the economic slack of the present recession has been absorbed, and this slack is judged to be the greatest since World War II. Contributing to an expected slowness in resurgence of nonresidential development are the previously-mentioned signals that the latest office building cycle has peaked. Thus, a fall in interest rates would increase the magnitude of nonresidential financing, but the upward trend should be relatively gradual into the mid-1980s.

Commercial banks should retain the shares which they have been recently enjoying in this increasing market, accounting for around 40 percent of long-term originations and between 70 and 75 percent of construction financing (does not include portion done through mortgage bankers). Any slippage in the share of the market captured by commercial banks will go to insurance companies, with savings associations and mutual savings banks having relatively stable and small shares of the market. Any improvement in savings inflows to these latter institutions would go first to liquidity needs and then to housing.

OUTLOOK FOR COMMERCIAL BANK SERVICES

The recent increase in the share of nonresidential loans obtained by commercial banks in a declining market is being obtained to a large extent by default. Insurance companies, savings associations and mutual savings banks, plagued by cash flow problems, have been less able to lend in this market. Pension funds have been seeking equities rather than loans, and their eagerness for real estate equities has been tempered by attractive short-term yields. Also at the present, developers are sensing the potential for lower interest rates and more favorable terms. Both from necessity, because of the absence of traditional long-term lenders from the market, and by choice, when developers are waiting for less stringent terms, commercial banks find their construction loans being extended and their short-term floating rate loans being used.

In an inflationary economy, with relatively high-cost, unstable, interest-rate sensitive liabilities, the commercial bank is an effective competitor for nonresidential loans. The risks of unanticipated increases in interest rates and loss of purchasing power are adequately dealt with by lending relatively short-term with fees and floating rates that provide an adequate yield. An interesting question exists concerning the commercial bank's ability to compete for nonresidential loans in a more stable economy, where inflation has been reduced, the yield curve has normalized, and interest rates are less volatile. Is the conventional long-term, fixed rate mortgage forever dead in such an economy?

Some observers contend that the above conditions would lead to a return to previous long-term lending arrangements. However, the lessons of the recent past, so sorely learned, will not be quickly forgotten by lenders. A more reasonable assumption would be that lenders will continue to seek protection against inflation and interest rate risk through participations and floating rates. Developers, however, would be expected to bargain for a greater share of the benefits of ownership.

The developer in a more stable economy is likely to have two basic choices in financing a property. One choice would be a long-term, fixed rate mortgage with some participation by the lender in rents, net income or cash flow. The degree of participation and the proportion of the benefits of ownership retained by a borrower would depend upon the availability of funds from lenders and the need for funds to finance nonresidential real estate. As discussed previously, the demand for nonresidential financing will materialize slowly. On the other hand, the funds available to meet that demand also are apt to increase gradually. Bonds, in this market, would be attractive alternative investments for pension funds and other lenders, resulting in real estate again being a second choice by many institutions for acquisition or financing. Other lenders, such as savings associations, would require some time to become significant suppliers of funds in this market, and the Federal Reserve can be expected to exercise restraint to avoid any lingering inflationary tendencies. The ability of lenders to extract participations and ownership benefits from developers should be expected to persist for a considerable time, only disappearing after a prolonged period of economic stability.

The developer's second alternative is apt to be a long-term loan with a floating rate. Commercial banks could respond to the competition by increasing the effective term of nonresidential loans. However, a reluctance to abandon the floating rate would be expected, just as other lenders would not relinquish participations. The banks would not be expected to offer fixed rate loans, even though their liabilities may have lengthened and their cost of funds had become more stable, unless the value of the loan could be protected through participation arrangements or by hedging in a futures market.

The developer, then, conceivably may be choosing between a fixed-rate loan with participation by the lender or a floating rate. In this instance, the developer may well prefer the fixed rate loan with participation, which would provide a more direct relationship between debt service and the property's net income or ability to pay. Without expanded lending powers, commercial banks would be unable to respond effectively to this need. In this situation, with a more stable economy, commercial banks may find their share of the nonresidential financing market declining.

ATTACHMENT III

The Future Of Bank Financial Services For Housing

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INTRODUCTION AND SUMMARY

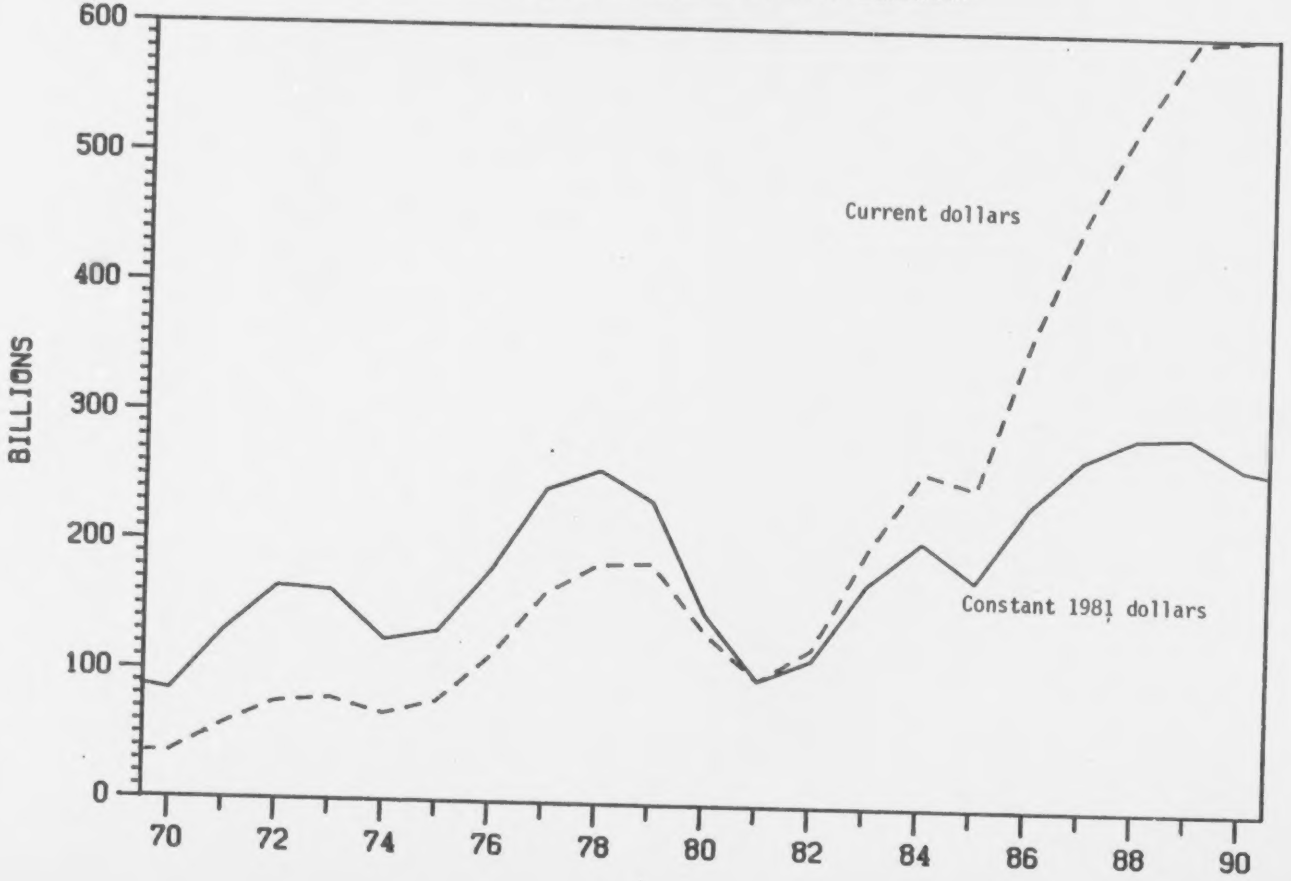
Demographic changes over the next decade will produce a rapid increase in the number of family-type households, which will create a heavy demand for credit to purchase new and existing single family homes. This expanded demand for owner-occupied housing and housing finance will collide with the inability of thrift institutions to provide their traditional share of mortgage credit from deposit funds. The resulting mortgage credit gap will be filled primarily by secondary market sales of mortgages, largely in the form of guaranteed mortgage passthrough securities, to institutional investors such as insurance companies and pension funds and to private individual investors.

In order to draw forth the additional funds from the secondary market, the yield on mortgages will have to rise relative to yields on other investments. During the late 1960's and throughout the 1970's, mortgage rates were unnaturally low relative to bond yields as a result of the regulatory treatment of depository institutions plus government intervention in the market. In the 1980's fixed rate mortgages will average about 200 basis points above corporate bond yields, with the spread increasing during periods of interest rate uncertainty.

For commercial banks, the increased relative yield on mortgages and the development of new mortgage instruments which provide some protection against adverse interest rate movements will make mortgages more attractive investments. As a result, mortgages should account for an increased share in bank asset portfolios.

Figure 1

TOTAL 1-4 FAMILY MORTGAGE ORIGINATIONS
IN CURRENT AND CONSTANT DOLLARS



The reliance on the secondary mortgage market will increase the importance of the mortgage banking function. This function will continue to be performed primarily by bank-affiliated or independent mortgage banking companies, but increasingly other mortgage originators, especially thrifts, will act more like mortgage bankers. Commercial banks will also find the origination and servicing fees increasingly important sources of profit.

The housing affordability problems posed by inflation and resulting high interest rates are cash flow problems and are directly related to the nature of the traditional mortgage instrument, which places unbearable burdens on the borrower in the initial years of ownership. Most new mortgage instruments do not address the borrower's cash flow problem any better. The market response has been to bypass institutional lenders and turn to various forms of seller financing. Ideally, the problem will be eliminated by the disappearance of inflation, but in the absence of such an ideal world it would behoove the housing finance industry to find other ways to address the borrower's needs.

HOUSING DEMAND

Over the past decade, there was a large increase in the number of young, nontraditional households among home buyers. The number of housing units owned by non-husband-wife households with heads under 35 years old increased from 550 thousand in 1970 to 2.2 million in 1979. This was the result of three factors:

1. An increase in the population aged 20 to 35 resulting from the post World War II baby boom.
2. An increase in nontraditional households due to a breakdown of marriage and an increased tendency for single people to establish their own households.
3. A greater propensity toward homeownership, which was true of all types of households, but which was proportionately greater among young, nonfamily households.

The coming decade will see a shift in the age structure toward older age groups. The rapid increase in the divorce rate and the growth of nonfamily households will slow, while the growth in family households will accelerate. The headlong rush toward homeownership as an inflation hedge based on underpriced mortgage credit will slow, but the demographic changes will fuel a continued demand for single family owner-occupied housing. The net result will be a shift in the types of households demanding housing and in types of housing they will demand.

Population and Households

The most positive factor in housing demand over the next few years is the maturation of the baby boom generation. The number of births reached a peak of 4.3 million in 1957. Beginning in 1963 it dropped precipitously. The babies born in the peak year of 1957 are now 25 years old, and they have thus reached the age where they will begin to seriously consider buying homes.

FIGURE 2
BIRTHS - 1909 TO PRESENT

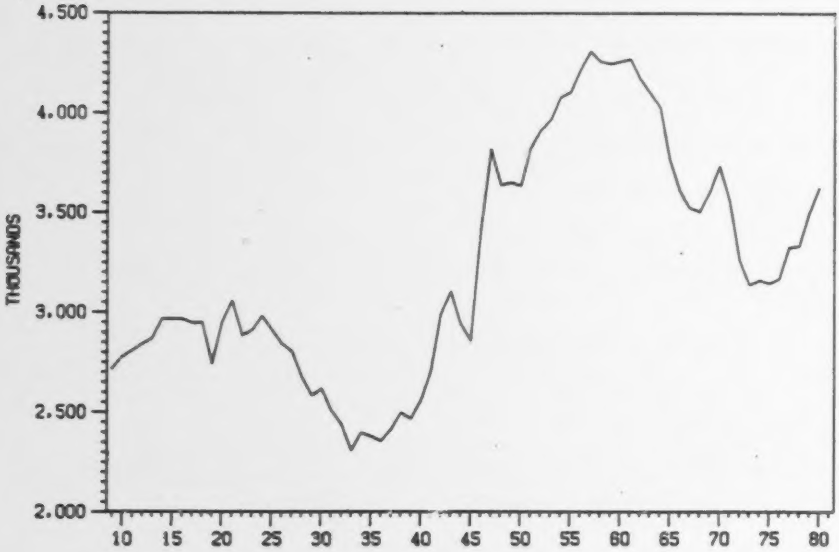


Figure 3
POPULATION BY AGE

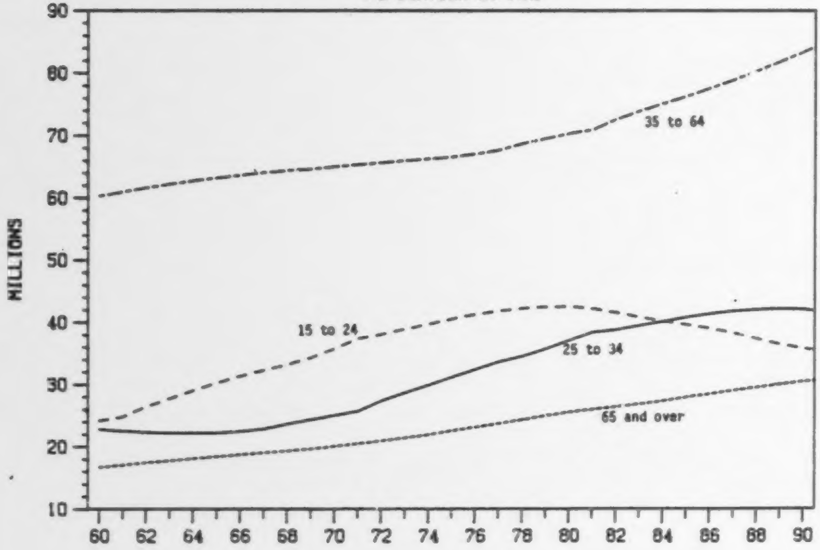


Figure 3 shows the age structure of the adult population. The changes in the relative size of the various age groups are caused primarily by historical fluctuations in births. The number of people aged 15 to 24 has already begun to decline. The 25 to 34 year old group will continue to increase until late in this decade, but the rate of increase is declining. The most rapid growth is occurring among the 35 to 64 year old group--particularly the 35 to 44 year olds.

While the growth in the adult population sets the stage for growth in housing demand, the actual number of housing units demanded depends on the way in which the population groups itself into households. If everyone lived alone, we would require about 230 million housing units, rather than the 82 million currently occupied.

A household is defined as a person or group of people who occupy a housing unit. Over the decade of the 1970's, the average household size fell from 3.2 to 2.8 people, with a consequent increase in the number of occupied housing units relative to the population. While part of the decline in average household size was due to decreases in the number of children, much of it also came from an increased tendency for adults--particularly young adults--to live alone.

We can measure the propensity to form households by the headship rate--the number of household heads relative to the total population in a particularly category. Table 1 shows the proportion of the population in each age bracket who were heads of households in 1970 and 1980. The total headship rate is divided into heads of family households and heads of nonfamily households. A family household is a group where the head of the household is related to at least one other member of the household. Most family households are traditional husband-wife households, although they may also consist of single parents or other relatives. Nonfamily households consist primarily of people living alone, although the category also includes roommates and unmarried couples. Since 1970 the proportion of the population in each age group who were heads of family households has been stagnant or declining, while the proportion who were heads of nonfamily households has grown dramatically.

Table 1
HEADSHIP RATES BY AGE

	---FAMILY----		--NONFAMILY--		----TOTAL----	
	1970	1980	1970	1980	1970	1980
15-24	9.9%	9.0%	2.5%	6.5%	12.4%	15.4%
25-34	42.6	38.6	4.5	11.7	47.1	50.2
35-44	47.6	47.8	3.7	6.9	51.3	54.7
45-54	47.1	47.0	6.2	8.2	53.2	55.2
55-64	45.1	44.0	13.2	13.8	58.3	57.8
65&OVER	35.6	35.3	26.2	29.6	61.7	64.9

There is a popular misconception that the growth in the number of young nonfamily households has resulted in large measure from children leaving their parents' homes and moving into apartments at an earlier age. As Table 2 shows, this has not been the case. The proportion of young adults living with their parents has actually increased over the past decade. Moreover, the headship increases have not resulted from fewer young people living with roommates

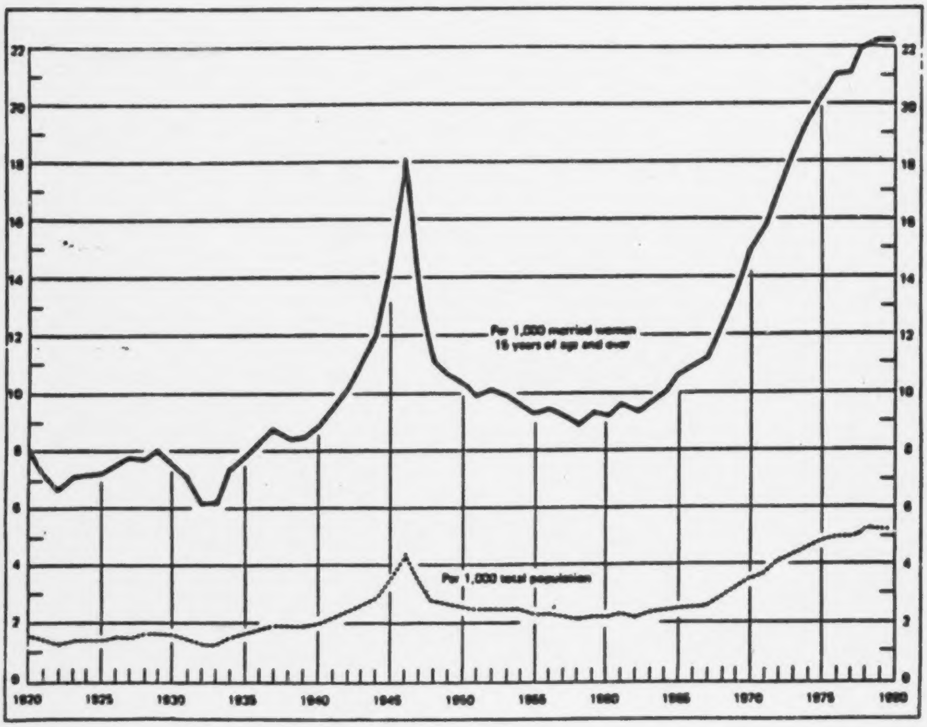
Table 2
LIVING ARRANGEMENTS BY AGE

	ALL AGES		14-17		18-19		20-24		25-29		30-34	
	1970	1979	1970	1979	1970	1979	1970	1979	1970	1979	1970	1979
HEAD OF FAM HH	35.2%	33.9%	0.2%	0.2%	3.0%	2.9%	21.1%	17.4%	40.7%	35.5%	45.9%	43.1%
HEAD OF NONFAM HH	8.2	11.7	0.0	0.1	1.6	3.7	4.8	11.5	5.1	12.8	3.5	8.5
NON-HEAD:												
WIFE OF HEAD	30.6	28.1	0.8	0.6	9.5	6.5	29.4	21.4	40.6	33.6	42.7	37.4
CHILD OF HEAD	19.4	19.3	93.7	93.7	76.0	76.4	34.4	37.2	8.1	9.4	4.1	5.1
OTHER RELATIVE	4.7	3.9	4.4	4.1	6.5	5.5	6.0	4.6	3.2	3.4	2.2	2.5
NON-RELATIVE	1.5	2.8	0.8	1.0	2.5	4.4	3.7	7.5	2.0	4.9	1.2	3.0
LIVING IN GROUP	0.4	0.3	0.2	0.2	0.9	0.6	0.5	0.4	0.3	0.3	0.3	0.4
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

	35-39		40-44		45-54		55-64		65-74		75+	
	1970	1979	1970	1979	1970	1979	1970	1979	1970	1979	1970	1979
HEAD OF FAM HH	47.9%	47.5%	47.9%	47.8%	47.0%	47.6%	45.5%	45.3%	39.7%	39.5%	34.5%	31.8%
HEAD OF NONFAM HH	3.3	6.6	3.9	6.4	6.1	7.5	13.4	14.3	24.4	26.6	33.7	40.1
NON-HEAD:												
WIFE OF HEAD	42.8	39.3	42.5	38.8	40.5	38.7	33.8	35.3	24.7	26.3	12.3	12.8
CHILD OF HEAD	3.0	2.9	3.0	3.0	2.3	2.1	1.1	0.8	0.2	0.1	0.0	0.0
OTHER RELATIVE	1.8	1.8	1.6	1.8	2.6	2.2	4.4	2.9	8.7	6.0	17.4	14.0
NON-RELATIVE	0.8	1.6	1.0	1.8	1.1	1.6	1.2	1.1	1.6	1.3	1.4	1.2
LIVING IN GROUP	0.4	0.2	0.1	0.5	0.3	0.3	0.6	0.3	0.8	0.2	0.6	0.1
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

either. The proportion of young people living in a household headed by a non-relative has also increased (partly due to the rise in unmarried couples). The growth in the number of young nonfamily households is entirely attributable to the incredible increase in the divorce rate and to the postponement of marriage.

Figure 4
DIVORCE RATES
UNITED STATES
1920-1980



Because total headship rates are higher for the older age groups, the aging of the baby boom generation would produce more households even if there were no further increases in headship rates. Moreover, the shift in the age distribution will produce more family households, since such households predominate among 35 to 64 year olds. During the 1970's, the increase in the number of nonfamily households exceeded the increase in family households, although family households still accounted for 74% of the total at the end of the decade. In the 1980's, family households should account for most of the increase, even if the social trends of the past decade continue.

It is hazardous to predict the future course of divorce rates or marriage rates. Although the changes observed in the 1970's are unlikely to be reversed, it is also unlikely that the movement away from marriage will be as severe in the coming years. The divorce rate has increased much less rapidly in recent years following the sharp increases in the late 1960's and early 1970's.

Economic factors influence headship rates, both directly by affecting the ability of people to afford separate housing units and indirectly by affecting marriage, divorce, and child-bearing patterns. The principal economic factors affecting headship rates are real disposable income, employment opportunities (measured by the unemployment rate), and the cost of housing. The number of nonfamily households is more sensitive to these factors than the number of family households. Table 3 shows our forecasts of the number of households under each economic scenario.

Table 3
RDA HOUSEHOLD FORECAST UNDER ALTERNATIVE SCENARIOS
(thousands)

	1980	---BASE CASE---		--OPTIMISTIC--		-PESSIMISTIC-	
		1990	CHANGE	1990	CHANGE	1990	CHANGE
FAMILY HOUSEHOLDS:							
15-24	3,815	3,155	-659	3,236	-578	3,035	-780
25-34	14,338	16,010	1,672	16,873	2,535	14,549	210
35-44	12,300	17,584	5,284	17,667	5,367	17,455	5,155
45-54	10,744	12,061	1,317	12,066	1,322	12,058	1,314
55-64	9,577	9,389	-189	9,548	-30	9,174	-404
65&OVER	9,046	10,451	1,405	10,583	1,537	10,268	1,222
TOTAL	59,820	68,650	8,831	69,972	10,152	66,537	6,717
NONFAMILY HOUSEHOLDS:							
15-24	2,755	3,847	1,092	4,038	1,283	3,489	734
25-34	4,334	7,050	2,715	7,155	2,821	6,828	2,494
35-44	1,769	3,209	1,439	3,387	1,617	2,984	1,215
45-54	1,882	2,117	235	2,181	300	2,002	120
55-64	2,995	3,118	123	3,185	190	3,033	38
65&OVER	7,590	9,810	2,220	10,387	2,797	8,904	1,314
TOTAL	21,326	29,151	7,825	30,334	9,008	27,240	5,914
ALL HOUSEHOLDS	81,145	97,801	16,656	100,306	19,160	93,777	12,631

Table 4a
HOUSING AND TENURE TYPE
BY HOUSEHOLD TYPE AND AGE OF HEAD
MILLIONS OF HOUSEHOLDS - 1979

	-SINGLE FAMILY-			--MULTIFAMILY--			----MOBILE----			TOTAL
	OWN	RENT	TOTAL	OWN	RENT	TOTAL	OWN	RENT	TOTAL	
HUSBAND-WIFE HOUSEHOLDS:										
UNDER 25	0.8	0.6	1.4	0.0	1.0	1.0	0.3	0.1	0.4	2.8
25-34	6.8	1.6	8.4	0.3	1.9	2.2	0.5	0.1	0.6	11.3
35-44	7.8	0.9	8.6	0.2	0.8	1.0	0.2	0.0	0.3	9.9
45-54	7.3	0.6	7.9	0.3	0.5	0.8	0.2	0.0	0.2	8.9
55-64	6.4	0.4	6.8	0.3	0.5	0.8	0.3	0.0	0.3	7.9
65 & OVER	5.2	0.3	5.5	0.4	0.7	1.2	0.3	0.0	0.4	7.1
ALL AGES	34.2	4.4	38.6	1.5	5.5	7.0	1.9	0.3	2.2	47.8
OTHER MALE HEAD - 2+ PERSONS:										
UNDER 25	0.1	0.2	0.3	0.0	0.5	0.5	0.0	0.0	0.1	0.8
25-34	0.3	0.2	0.5	0.0	0.5	0.5	0.0	0.0	0.1	1.1
35-44	0.3	0.1	0.3	0.0	0.1	0.2	0.0	0.0	0.0	0.5
45-54	0.3	0.0	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.4
55-64	0.2	0.0	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.3
65 & OVER	0.3	0.0	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.4
ALL AGES	1.4	0.6	2.0	0.2	1.3	1.5	0.1	0.1	0.2	3.6
FEMALE HEAD - 2+ PERSONS:										
UNDER 25	0.1	0.2	0.3	0.0	0.8	0.8	0.0	0.0	0.1	1.2
25-34	0.6	0.5	1.1	0.0	1.2	1.3	0.1	0.0	0.1	2.5
35-44	0.8	0.4	1.2	0.1	0.7	0.7	0.1	0.0	0.1	2.0
45-54	0.8	0.2	1.0	0.0	0.4	0.4	0.0	0.0	0.0	1.4
55-64	0.7	0.2	0.9	0.1	0.2	0.3	0.0	0.0	0.0	1.2
65 & OVER	0.9	0.2	1.1	0.1	0.2	0.3	0.0	0.0	0.0	1.4
ALL AGES	3.9	1.7	5.6	0.3	3.5	3.8	0.2	0.1	0.4	9.7
MALE LIVING ALONE:										
UNDER 25	0.1	0.1	0.2	0.0	0.6	0.6	0.0	0.0	0.1	0.8
25-34	0.4	0.2	0.7	0.1	1.0	1.0	0.1	0.0	0.1	1.8
35-44	0.2	0.1	0.3	0.0	0.4	0.5	0.0	0.0	0.0	0.8
45-54	0.2	0.1	0.3	0.1	0.4	0.4	0.0	0.0	0.1	0.8
55-64	0.3	0.1	0.4	0.0	0.3	0.4	0.0	0.0	0.1	0.9
65 & OVER	0.7	0.2	0.8	0.1	0.5	0.6	0.1	0.0	0.1	1.5
ALL AGES	1.9	0.8	2.7	0.3	3.1	3.5	0.3	0.1	0.4	6.6
FEMALE LIVING ALONE:										
UNDER 25	0.0	0.1	0.1	0.0	0.6	0.6	0.0	0.0	0.0	0.8
25-34	0.2	0.1	0.3	0.0	0.9	1.0	0.0	0.0	0.0	1.3
35-44	0.1	0.0	0.2	0.0	0.3	0.3	0.0	0.0	0.0	0.5
45-54	0.3	0.1	0.4	0.1	0.4	0.5	0.0	0.0	0.1	0.9
55-64	0.9	0.2	1.1	0.1	0.7	0.8	0.1	0.0	0.1	2.0
65 & OVER	2.8	0.5	3.3	0.4	1.8	2.3	0.3	0.0	0.3	5.8
ALL AGES	4.4	0.9	5.3	0.7	4.7	5.4	0.5	0.1	0.5	11.2
ALL TYPES	45.7	8.4	54.1	3.0	18.1	21.2	3.0	0.7	3.6	79.0

NOTE: Other male head includes all family and nonfamily households of 2 or more persons headed by a male except husband-wife households.

Table 4b
HOUSING AND TENURE TYPE
BY HOUSEHOLD TYPE AND AGE OF HEAD
1979

	-SINGLE FAMILY-			--MULTIFAMILY--			----MOBILE----			TOTAL
	OWN	RENT	TOTAL	OWN	RENT	TOTAL	OWN	RENT	TOTAL	
HUSBAND-WIFE HOUSEHOLDS:										
UNDER 25	27%	23%	50%	1%	35%	36%	9%	4%	14%	100%
25-34	60	14	75	2	17	20	5	1	6	100
35-44	78	9	87	2	8	10	3	0	3	100
45-54	82	6	88	3	6	9	3	0	3	100
55-64	81	5	86	4	7	10	3	0	3	100
65 & OVER	73	5	78	6	11	17	5	0	5	100
ALL AGES	71%	9%	81%	3%	11%	15%	4%	1%	5%	100%
OTHER MALE HEAD - 2+ PERSONS:										
UNDER 25	9%	23%	32%	1%	59%	60%	3%	5%	8%	100%
25-34	26	18	44	4	45	49	4	2	7	100
35-44	49	13	62	6	26	32	3	2	6	100
45-54	58	11	68	9	21	29	2	0	3	100
55-64	61	12	72	6	18	24	3	1	4	100
65 & OVER	71	10	81	5	13	18	1	0	1	100
ALL AGES	38%	16%	54%	4%	36%	41%	3%	2%	5%	100%
FEMALE HEAD - 2+ PERSONS:										
UNDER 25	6%	21%	27%	1%	67%	68%	2%	3%	5%	100%
25-34	23	22	45	2	49	50	3	2	5	100
35-44	41	18	59	3	34	37	3	1	4	100
45-54	52	15	68	3	26	30	2	0	3	100
55-64	61	14	74	6	17	23	3	0	3	100
65 & OVER	65	11	76	6	16	22	2	0	2	100
ALL AGES	40%	17%	57%	3%	36%	39%	3%	1%	4%	100%
MALE LIVING ALONE:										
UNDER 25	7%	16%	23%	1%	69%	69%	6%	2%	8%	100%
25-34	24	12	37	5	54	58	3	2	5	100
35-44	25	11	36	5	53	58	4	2	6	100
45-54	26	13	39	7	46	54	6	2	8	100
55-64	39	11	50	5	37	42	6	2	7	100
65 & OVER	43	12	55	6	33	39	5	1	6	100
ALL AGES	29%	12%	41%	5%	48%	52%	5%	2%	6%	100%
FEMALE LIVING ALONE:										
UNDER 25	3%	10%	13%	0%	83%	83%	1%	3%	4%	100%
25-34	13	9	22	4	72	76	1	1	2	100
35-44	23	9	32	9	53	62	4	2	6	100
45-54	35	8	43	8	43	51	6	0	6	100
55-64	48	8	55	6	34	[illegible]	5	1	5	100
65 & OVER	48	8	56	7	32	[illegible]	5	1	5	100
ALL AGES	39%	8%	47%	6%	42%	48%	4%	1%	5%	100%

Housing Choice

The type of housing occupied by a household is largely determined by its demographic character as well as its income, mobility, and longevity (which are closely related). Tables 4a and 4b shows the distribution among structure types (single family, multifamily, mobile) and tenure types (owner, renter) for households in 1979. Among traditional husband-wife households, particularly those headed by someone 35 to 64 years old, single family owner-occupied housing is the overwhelming choice. Rental multi-family housing is favored more by people living alone, especially the young. Mobile homes are favored most by young family households.

About 66% of households own their homes, up from about 63% in 1970. The modest increase in this percentage is the result of two dramatic but conflicting changes. As was noted above, there has been a dramatic increase in the number of young, non-family households. Normally this would have produced a decline in the homeownership percentage, since those households are typically renters. However, during the same period there was a sharp increase in the propensity toward homeownership by all household types (see table 5). Among husband-wife households, the homeownership percentage increased from 71% to 79%. For husband-wife households with heads under 35, the increases were even greater. For people 25 to 34 years old living alone, the ownership percentage increased from 16% to 26% just in the three years from 1976 to 1979.

Table 5
Owner Occupants as a Percentage of Total Households

	1970	1974	1975	1976	1977	1978	1979
All Households	62.9	64.6	64.7	64.8	64.8	65.2	65.5
Husband-Wife	70.7	74.8	75.4	76.1	77.1	78.1	78.5
Under 25	26.0	32.5	31.3	32.4	35.3	37.0	37.5
25 to 34	56.8	63.4	63.5	65.0	65.7	67.3	67.2
35 to 44	76.7	80.4	81.0	81.1	82.1	82.7	83.0
45 to 54	80.8	85.2	86.3	86.5	86.9	87.3	87.3
55 to 64		84.6	85.3	86.1	86.5	87.6	88.1
65 and over	78.4	81.7	82.6	82.9	83.1	84.0	84.5
Other Male, 2+ pers	55.8	48.7	49.3	48.0	47.7	48.4	48.1
Under 25	27.6	12.2	11.4	11.5	10.7	13.3	13.8
25 to 34		26.0	32.3	31.4	33.3	33.3	36.0
35 to 44	65.3	59.3	60.5	59.9	54.8	61.0	60.9
45 to 54		70.2	66.3	63.6	67.9	68.2	69.9
55 to 64		69.7	71.2	69.6	72.6	74.7	72.5
65 and over	72.2	74.0	76.3	80.2	79.7	80.2	78.4
Female Head, 2+ pers	48.0	46.7	46.5	46.0	46.0	45.8	45.6
Under 25	20.6	7.2	4.7	6.0	6.9	8.9	8.7
25 to 34		24.6	25.8	25.8	26.0	29.1	27.7
35 to 44	53.7	45.7	45.0	45.5	46.9	46.1	47.1
45 to 54		59.5	59.6	60.9	59.7	58.6	57.8
55 to 64		67.8	71.5	69.2	72.2	69.8	68.9
65 and over	69.7	70.9	71.1	70.8	70.6	70.9	72.4
Living Alone	42.7	42.8	42.5	42.2	42.2	44.2	45.2
Under 25	11.8	7.0	6.5	7.7	7.6	9.9	9.1
25 to 34		16.5	16.4	15.8	19.2	23.3	26.2
35 to 44	41.6	28.8	28.3	28.4	27.0	34.5	35.0
45 to 54		39.0	39.0	39.5	41.4	42.0	44.3
55 to 64		54.5	53.9	53.5	52.3	54.0	55.7
65 and over	54.1	56.4	56.2	56.6	57.1	58.4	58.8

The dramatic increase in the propensity toward homeownership among all types of households was due in large measure to anticipated capital gains juxtaposed against cheap mortgage finance. Homeownership was perceived, correctly, as an excellent inflation hedge. With mortgage finance not so underpriced, and with capital gains apparently not so inevitable, it is unlikely that the shift toward homeownership will continue. For many types of households, particularly those types which historically have not been homeowners, it may even be partly reversed. Since the population age distribution is now shifting toward the middle-aged groups who are most inclined toward homeownership, the aggregate percentage of homes which are owner-occupied should continue to increase.

Affordability

Over the past decade, house prices and average monthly mortgage payments on newly purchased houses rose faster than incomes (see table 6). Yet, as discussed above, there was a shift toward homeownership over the same period and there was an increase in the size and an improvement in the quality of new homes built.

Table 6
HOUSING COST VS. INCOME

	MEDIAN EXISTING HOME	MORTGAGE RATE	MORTGAGE. PAYMENT	MEDIAN FAMILY INCOME	PRICE /INCOME	PAYMENT /INCOME
1960	$15,950	6.26%	$ 884	$5,620	2.84	0.16
1965	18,500	5.81%	978	6,957	2.66	0.14
1970	23,000	8.45%	1,584	9,867	2.33	0.16
1971	24,800	7.74%	1,598	10,285	2.41	0.16
1972	26,700	7.60%	1,697	11,116	2.40	0.15
1973	28,900	7.95%	1,900	12,051	2.40	0.16
1974	32,000	8.92%	2,301	12,902	2.48	0.18
1975	35,300	9.01%	2,559	13,719	2.57	0.19
1976	38,100	8.99%	2,757	14,958	2.55	0.18
1977	42,900	9.01%	3,109	16,009	2.68	0.19
1978	48,700	9.54%	3,698	17,640	2.76	0.21
1979	55,700	10.77%	4,687	19,661	2.83	0.24
1980	62,200	12.66%	6,044	21,023	2.96	0.29
1981	66,400	14.70%	7,413	23,000	2.89	0.32

Mortgage payment based on 30 year mortgage with 25% down payment

Data sources: Income - Census Bureau (Current Population Survey)
Mortgage Rate - Federal Home Loan Bank Board
House Price - National Assn. of Realtors

This seemingly anomalous experience reflects the fact that the homebuyer was looking beyond the initial price and monthly cash outlay and was taking account of income tax savings and future capital gains. Table 7 shows the total net cost of homeownership, with the assumption that home buyers expected house prices to increase at the rate experienced in the preceding three years.

Table 7
ANNUAL USER COST OF HOUSING

	(1) MORTGAGE PAYMENT	(2) OPPORTUNITY COST OF DOWNPAYMENT	(3) PROPERTY TAX	(4) MAINTE-NANCE	(5) INCOME TAX SAVINGS	(6) EXPECTED CAPITAL GAIN	(7) USER COST (1)+(2)+(3) +(4) -(5)-(6)	USER COST /INCOME
1970	1,584	462	345	230	334	1,384	903	9.2%
1971	1,598	458	372	248	244	1,781	651	6.3%
1972	1,697	481	401	267	182	1,848	816	7.3%
1973	1,900	538	434	289	285	2,262	612	5.1%
1974	2,301	686	480	320	429	2,808	549	4.3%
1975	2,559	779	530	353	392	3,407	422	3.1%
1976	2,757	803	572	381	416	3,638	458	3.1%
1977	3,109	860	644	429	441	4,357	244	1.5%
1978	3,698	1,063	731	487	740	5,456	-217	-1.2%
1979	4,687	1,341	836	557	1,022	7,437	-1,038	-5.3%
1980	6,044	1,857	933	622	1,587	8,112	-243	-1.2%
1981	7,413	2,352	996	664	2,105	7,153	2,168	9.4%

Opportunity cost based on AAA bond rate

Tax savings includes absence of tax on opportunity cost and is based on estimates of marginal tax rates and excess standard deductions shown in Douglas Diamond,"Taxes, Inflation, Speculation, and the Cost of Homeownership" AREUEA Journal (Fall 1980).

The ratios of house price to income and monthly payment to income are not irrelevant. They are measures of the cash flow constraints. The current problem of housing affordability is primarily a problem of cash flow rather than overall cost, related to the effects of chronic inflation on interest rates.

To see the impact of inflation on mortgage payments, consider a situation where all wages, prices, and nominal interest rates fully reflect the inflation rate and where the following conditions exist at the start:

Household Income = $20,000
House Price = $50,000
Down Payment = $10,000
Real Interest Rate = 3 1/2%
Real Income Growth = 2%

Table 8a shows the mortgage payment at different points over the life of the mortgage loan under an assumption of no inflation. Initially, mortgage payments absorb 10.9% of the household's gross income. Because of the assumed increase in real income, the fixed mortgage payment becomes gradually less of a burden over time, and in the 25th year represents 6.8% of the household's income.

Table 8a
MORTGAGE PAYMENTS WITH
INFLATION RATE = 0%

YEAR	ANNUAL MORTGAGE PAYMENT	INCOME	PAYMENT /INCOME	MARKET VALUE OF HOUSE	LOAN PRINCIPAL	EQUITY
1	2,175	20,000	10.9%	50,000	39,225	10,775
2	2,175	20,400	10.7%	50,000	38,423	11,577
3	2,175	20,808	10.5%	50,000	37,593	12,407
4	2,175	21,224	10.2%	50,000	36,734	13,266
5	2,175	21,649	10.0%	50,000	35,845	14,155
10	2,175	23,902	9.1%	50,000	30,910	19,090
15	2,175	26,389	8.2%	50,000	25,049	24,951
20	2,175	29,136	7.5%	50,000	18,087	31,913
25	2,175	32,168	6.8%	50,000	9,820	40,180
30	2,175	35,516	6.1%	50,000	0	50,000

Now consider a world with a 12% inflation rate. The nominal interest rate becomes 15 1/2%, requiring an annual mortgage payment of $6,283, representing 31.4% of income in the first year. With income increasing at 14% per year (2% real growth plus the inflation rate), the fixed mortgage payment represents only 9.7% of income in ten years and on 2.6% in twenty.

Table 8b
MORTGAGE PAYMENTS WITH
INFLATION RATE = 12%

YEAR	ANNUAL MORTGAGE PAYMENT	INCOME	PAYMENT /INCOME	MARKET VALUE OF HOUSE	LOAN PRINCIPAL	EQUITY
1	6,283	20,000	31.4%	50,000	39,917	10,083
2	6,283	22,800	27.6%	56,000	39,820	16,180
3	6,283	25,992	24.2%	62,720	39,709	23,011
4.	6,283	29,631	21.2%	70,246	39,581	30,666
5	6,283	33,779	18.6%	78,676	39,433	39,243
10	6,283	65,039	9.7%	138,653	38,266	100,387
15	6,283	125,226	5.0%	244,355	35,870	208,485
20	6,283	241,110	2.6%	430,636	30,943	399,693
25	6,283	464,236	1.4%	758,927	20,816	738,111
30	6,283	893,845	0.7%	1,337,490	0	1,337,490

Table 8c shows an intermediate case with 6% inflation:

Table 8c
MORTGAGE PAYMENTS WITH
INFLATION RATE = 6%

YEAR	ANNUAL MORTGAGE PAYMENT	INCOME	PAYMENT /INCOME	MARKET VALUE OF HOUSE	LOAN PRINCIPAL	EQUITY
1	4,067	20,000	20.3%	50,000	39,733	10,267
2	4,067	21,600	18.8%	53,000	39,440	13,560
3	4,067	23,328	17.4%	56,180	39,120	17,060
4	4,067	25,194	16.1%	59,551	38,769	20,782
5	4,067	27,210	14.9%	63,124	38,385	24,739
10	4,067	39,980	10.2%	84,473	35,842	48,632
15	4,067	58,743	6.9%	113,044	31,839	81,205
20	4,067	86,312	4.7%	151,278	25,537	125,741
25	4,067	126,820	3.2%	202,443	15,617	186,826
30	4,067	186,339	2.2%	270,914	0	270,914

Relative to income and relative to purchasing power, the traditional mortgage instrument in an inflationary environment requires the borrower to make larger payments at the start and smaller payments in the later years. What is required in order to take account of chronic inflation is a mortgage instrument which calls for smaller nominal monthly payments at the start.

While lenders have produced a plethora of new mortgage instruments in the past two years, im most cases these new instruments have addressed the problems of lenders but not the problems of borrowers.

Adjustable rate mortgages do not address the borrower's cash flow problem. If rates are high but constant, as in the example above, an adjustable rate mortgage effectively becomes a fixed rate mortgage. It is only in the very limited sense that ARM's tend to carry slightly lower rates that they represent greater affordability.

Short-term interest-only mortgages do not produce a substantial reduction in payments, because at high rates very little amortization takes place in the initial years.

There are several mortgage instruments which do address the cash flow affordability problem. One major category is the Graduated Payment Mortgage, which provides for payments which are lower at first and which increase gradually under a predetermined schedule. Generally, this involves some negative amortization in the initial years. A second category is the Shared Appreciation Mortgage, by which the borrower sacrifices a share of the capital gains in return for a lower payment. A third type, the Equity Adjusted Mortgage, reduces the payments by increasing the loan as the value of the house increases--a sort of automatic second mortgage to pay the first mortgage.

Although the FHA section 245 graduated payment program has been relatively successful--accounting for about a third of FHA loans on 1 to 4 family homes--lenders have generally not responded to the home buyer's cash flow problems by offering these alternative mortgage instruments. The problem has been addressed instead by a variety of ad hoc arrangements involving participation by builders and sellers of existing homes. These ad hoc arrangements, which have come to be known as "creative financing" include buy-downs, loan assumptions, and seller financing. The current widespread use of creative financing is discussed below.

The reluctance of lenders to offer instruments such as graduated payment mortgage is often justified in terms of greater risk associated with instruments with negative amortization. The risk of default consists in part of the possibility of nonpayment and in part of the uncertainty that the securing property is sufficient collateral from which to obtain restitution. A graduated payment loan may increase the uncertainty about whether the collateral is sufficient, but it will generally decrease the likelihood of default, at least compared to alternatives such as loosening standards for maximum payment to income ratios, entering into buy-down arrangements providing for abrupt payment increases after a few years, or making ballooon payment short term loans.

Mobility

Americans have tended to be a restless lot. Nearly half of the population in 1980 lived in a different house than in 1975. Most of those who moved during that period remained in the same county, but about 20% of movers moved from another state or from abroad. 1/ While movement among homeowners was much less frequent than among renters (only 11% of homeowners moved in 1978 vs 37% of renters 2/), the housing turnover resulting from this frequent movement is a major contribution to mortgage credit demand.

The most mobile age group consists of people 25 to 30 years old. Once past 30, people are increasingly likely to stay put. The percent of people in 1980 who lived in a different house than in 1975 was as follows:

Table 9
People Living in Different House in 1980 than in 1975

Age	All Movers	Interstate
5 to 9	61.1%	11.4%
10 to 14	45.7	8.5
15 to 19	39.5	7.1
20 to 24	67.9	12.9
25 to 29	80.8	16.8
30 to 34	67.5	13.8
35 to 44	46.9	9.2
45 to 54	30.4	5.8
55 to 64	25.1	4.6
65 & Over	21.2	4.2

1/ U.S. Bureau of the Census, Current Population Reports, Series P20, No. 368, Geographical Mobility March 1975 to March 1980 (U.S. GPO, Washington, D.C. 1981)

2/ U.S. Bureau of the Census, Current Housing Reports, Series H-150-78, Housing Characteristics of Recent Movers for the United States and Regions: 1978, Annual Housing Survey, Part D (USGPO, Washington, 1980).

People with more education are likely to move more often and further than those with less education. The relationship to income is less clear.

The population age structure implies continued high mobility over the remainder of the decade. On the other hand, high mortgage rates discourage mobility, particularly among homeowners with non-assumable low rate mortgages. On balance, we expect the turnover of the owner-occupied housing stock to rise for most of the decade but to remain below the feverish rate of 1978. However, because the size of the housing stock will be greater, the number of existing home sales (which equals turnover rate times stock) will exceed the 1978 record in the latter part of the 1980's.

Interstate Migration

Net migration is by far the most important factor producing differences in relative housing construction activity among states.

The dominant net migration flows continue to be out of the Northeast and North Central states and into the South and West. Also, there is a continuing migration out of the central cities and into the suburbs and nonmetropolitan areas.

The movement of population both reflects and produces the more rapid growth of industry in the Sunbelt and non-urban areas. The movement of industry to the hinterlands has often been attributed to lower wage costs. But wage diffentials are no greater now than they were during the extended period when industry and population became concentrated in the urban areas of the Northeast and North Central regions. However, in the past it was much easier to operate a business in the established areas convenient to transportation, supplying industries, markets, skilled labor, etc. Changes in the technology and economics of transportation (notably as a result of the construction of the Interstate Highway System), improvements in communications, changes in the technology of production for many industries, and the increased attraction of the boondocks to skilled labor all combined to reduce the relative advantages of the older urban areas. Once set in motion, the process of industrial decentralization feeds on itself, as the infrastructure for further development is established. This process has by no means run its course, and we see no reason to expect a reversal of these trends in the foreseeable future.

In explaining and forecasting net migration of population by state we have found that the primary determinants are relative employment opportunities (measured as the difference between the state unemployment rates and national unemployment rate) and relative real income (the ratio of state per capita personal income divided by state cost of living index to national per capita personal income divided by national CPI).

The fact that workers are attracted by high real income, while industry is attracted by low nominal wages and other low costs points to the importance of living costs and costs of production in determining net migration flows.

Local area cost statistics are difficult to come by. At RDA we have constructed a state cost of living index comparable to the national CPI based on data from the BLS on prices in selected metropolitan areas. Table 10 shows these data and several other measures of costs for states. Note that although many of the sunbelt states have lower average costs, the faster-growing low cost areas have shown above-average increases in living costs since 1970, so that their cost advantage is diminishing.

Table 10
SELECTED MEASURES OF LIVING COSTS - 1980
WITH PERCENT CHANGE 1970-80

	RDA "CPI" INDEX			500 KWH ELECTRIC			MEDIAN HOUSE(1)			PER CAP TAXES(2)		
	1980	RANK	CHG	1980	RANK	CHG	1980	RANK	CHG	1980	RANK	CHG
ALABAMA	216	48	114%	23.63	32	153%	33,900	49	178%	386	51	167%
ALASKA	338	1	118	24.20	30	62	76,300	3	236	1,234	2	409
ARIZONA	243	26	119	31.02	11	159	54,700	14	236	919	7	178
ARKANSAS	217	47	118	22.61	37	122	31,100	51	196	434	50	248
CALIFORNIA	259	6	116	22.79	36	127	84,500	2	266	887	9	129
COLORADO	252	15	127	22.85	35	128	64,100	7	271	788	14	180
CONNECTICUT	259	5	107	33.93	8	210	65,600	6	157	763	16	173
DELAWARE	232	38	111	37.76	2	243	44,400	28	160	580	32	204
DIST OF COLUMBIA	248	20	108	20.09	45	127	68,800	4	223	1,067	4	213
FLORIDA	209	51	105	25.53	23	127	45,100	26	201	453	47	143
GEORGIA	219	46	115	21.70	42	136	36,900	41	153	567	35	186
HAWAII	277	3	100	37.65	3	180	118,100	1	236	1,028	5	141
IDAHO	242	29	125	13.65	50	46	45,600	23	223	536	37	158
ILLINOIS	254	13	112	27.55	17	155	52,600	16	167	788	15	120
INDIANA	242	28	113	26.60	20	159	37,200	40	170	599	29	126
IOWA	239	32	115	28.80	13	141	40,600	32	192	738	19	107
KANSAS	236	35	116	25.21	27	164	37,800	39	212	694	22	166
KENTUCKY	219	45	117	20.34	43	119	34,200	48	171	407	43	136
LOUISIANA	216	49	114	20.32	44	94	43,000	30	195	478	44	244
MAINE	261	4	124	26.05	21	120	37,900	38	196	635	26	141
MARYLAND	244	24	115	28.57	14	146	58,300	11	212	849	10	128
MASSACHUSETTS	280	2	106	34.41	6	196	48,400	18	135	1,246	1	252
MICHIGAN	250	18	116	25.65	22	230	39,000	35	123	831	11	186
MINNESOTA	247	21	113	23.57	33	116	53,100	15	195	792	13	177
MISSISSIPPI	215	50	120	25.02	28	160	31,400	50	180	477	45	171
MISSOURI	243	27	115	27.01	19	138	36,700	42	155	568	34	139
MONTANA	243	25	124	14.99	48	31	46,500	22	232	643	24	219
NEBRASKA	236	34	116	22.46	40	162	38,000	37	206	751	18	184
NEVADA	249	19	118	25.31	25	137	68,700	5	207	515	39	60
NEW HAMPSHIRE	257	9	115	34.41	7	202	48,000	19	193	460	46	233
NEW JERSEY	258	8	100	35.12	5	234	60,200	8	157	795	12	176
NEW MEXICO	241	30	122	30.85	12	197	45,300	25	248	507	40	210
NEW YORK	257	10	103	40.07	1	197	45,600	24	103	1,233	3	158
NORTH CAROLINA	223	42	117	24.05	31	156	36,000	44	181	521	38	191
NORTH DAKOTA	233	37	118	22.94	34	84	43,900	29	238	546	36	156
OHIO	244	23	117	28.26	15	171	44,900	27	155	599	28	244
OKLAHOMA	226	41	119	22.51	38	137	35,600	45	221	449	48	231
OREGON	254	14	123	16.01	46	128	56,900	13	269	707	21	153
PENNSYLVANIA	245	22	111	31.56	10	220	39,100	33	188	641	25	291
RHODE ISLAND	258	7	107	35.42	4	234	46,800	21	157	755	17	236
SOUTH CAROLINA	220	44	117	25.40	24	154	35,100	47	170	501	41	190
SOUTH DAKOTA	233	36	117	24.92	29	112	36,600	43	221	591	30	112
TENNESSEE	221	43	114	14.80	49	93	35,600	46	185	436	49	201
TEXAS	231	39	122	25.28	26	149	39,100	34	226	489	42	236
UTAH	251	17	122	27.86	16	204	57,300	12	241	681	23	182
VERMONT	257	12	119	27.10	18	164	42,200	31	157	617	27	83
VIRGINIA	238	33	114	33.10	9	228	48,000	20	181	590	31	181
WASHINGTON	257	11	122	9.40	51	56	59,900	9	224	718	20	125
WEST VIRGINIA	226	40	120	22.49	39	135	38,500	36	241	571	33	240
WISCONSIN	251	16	117	21.71	41	126	48,600	17	181	902	8	147
WYOMING	240	31	125	15.43	47	60	59,800	10	291	948	6	252

NOTES: (1) Median house value as reported in decennial census.
(2) Total state and local property, general sales, and individual income tax divided by resident population.

Housing Supply

The Supply of Existing Housing

In the short run, most housing demand is met by existing structures. Even in times of peak production, new construction in one year will represent less than 3% of the existing stock.

The quality of the housing stock has now improved to the point that, by most measures, there are very few remaining substandard units.

While not all units which are removed from the stock are substandard, the decline in substandard units suggests that replacement demand for housing will be smaller in the coming years than it has been in the past.

The breakdown of the housing stock into structure types in 1979 was as follows:

Table 11

	Total 1979 Stock		Stock built since 1970	
	Thousands	Percent	Thousands	Percent
All Year Round Units	84,586	100.0	18,146	100.0
Single Family Detached	53,879	63.7	9,760	53.8
Single Family Attached	3,401	4.0	772	4.3
2 to 4 Units	10,785	12.8	1,482	8.2
5 or more: Lowrise	9,081	10.7	3,195	17.6
Highrise	3,829	4.5	829	4.6
Mobile Homes	3,610	4.3	2,108	11.6

Source: Bureau of the Census, Annual Housing Survey, 1979

The relatively large proportions of multifamily units and mobile units added since 1970 reflect booms in those sectors in the early part of the decade. More recently, single family units have accounted for a larger share. With the demographic changes of the coming decade, we expect a further increase in the single family share of new construction.

Characteristics of New Construction

Throughout most of the last decade, new single family homes showed consistent, significant, improvement in terms of size and amenities. This is illustrated by the measures shown in table 12. In addition there were improvements in construction quality, most notably in the area of energy efficiency. After 1978, however, there has been some tendency toward smaller, less elaborate homes, consistent with the increase in user cost discussed above. The affordability problems have led a number of observers to predict that new houses will be smaller and more spartan in the coming years.

Table 12
Characteristics of SF Homes Completed

Year	Floor Area (Square Feet) Avg.	Median	Percent of homes with 2 or more Bathrooms	4 or more Bedrooms	Fire-place	Central Air	2 Car Garage
1966	1,535	1,460	50%	24%		25%	
1967	1,570	1,505	52	25		28	
1968	1,580	1,500	51	26		31	48%
1969	1,605	1,530	56	26	45%	36	49
1970	1,500	1,385	48	24	35	34	39
1971	1,520	1,375	48	24	36	36	39
1972	1,555	1,405	53	23	38	43	42
1973	1,660	1,525	60	23	44	49	48
1974	1,695	1,560	61	23	49	48	52
1975	1,645	1,535	60	21	52	46	53
1976	1,700	1,590	67	23	58	49	59
1977	1,720	1,610	70	23	61	54	60
1978	1,755	1,655	73	24	64	58	62
1979	1,760	1,645	74	23	62	60	62
1980	1,740	1,595	73	20	57	63	56

Source: Bureau of the Census, Construction Reports (Series C25)
Note: The 1970 decline is due to the influence of the Section 235 subsidy program.

While there may be some further movement toward smaller houses, with more town houses and cluster housing, we doubt that there will be any substantial shift in that direction. The affordability problems will probably be no more severe in the next few years than they are now, provided that inflation continues to abate and nominal interest rates decline. Moreover, single people, young couples, and first time home buyers, who would tend to favor smaller homes, are likely to account for a smaller share of new homes sales.

In some localities, land use controls or natural limits may force builders to use smaller lots and to build smaller, clustered houses.

The Mobile Home Share

Similar to the view that homes in the future will be smaller and more spartan is the idea that mobile homes (also known as manufactured housing) are the wave of the future. Mobile home shipments have displayed relative strength in the current housing depression, acoounting for 18% of the total supply of new housing units in 1981.

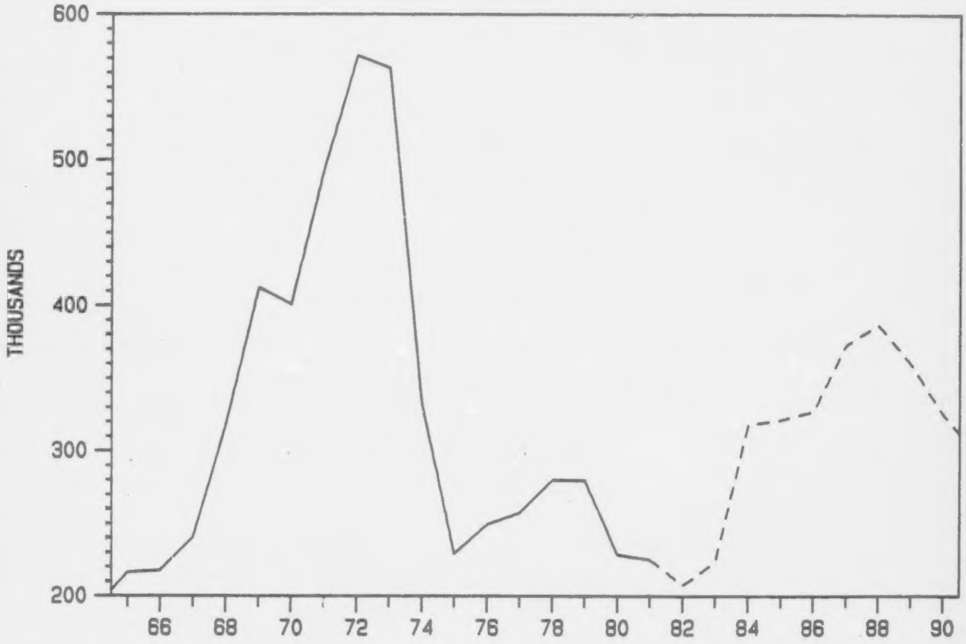
There are a number of reasons for viewing the prospects of mobile homes favorably, including continuing improvements in product quality, relaxation of zoning restrictions, and the fact that mobile homes have had their greatest acceptance in the sunbelt and nonmetropolitan areas which are enjoying the greatest population growth.

Tables 4a and 4b showed the distribution of mobile home occupancy among various household types in 1979. While the changes in the age structure over the next few years have very favorable implications for single family conventional housing, the implications for mobile homes are much less favorable. The groups with greatest propensity to live in mobile homes are households with heads under 35 years old, and especially those under 25 years old. The peak growth for these groups has already passed, and the group under age 25 is declining in size, reflecting the post-1962 "baby bust."

After increasing from 2.1 million in 1970 to 3.7 million in 1974, the number of occupied mobile homes remained essentially stagnant for the remainder of the decade of the 1970's. Between 1974 and 1979, the number of occupied mobile homes actually declined slightly to about 3.6 million. The 1.3 million mobile homes shipped during that period represented replacement demand. This indicates a removal rate of about 7 1/2% per year, implying an average lifetime of less than thirteen years--not very comforting for lenders making 15- to 20-year loans. The quality of mobile homes has improved significantly over the past decade, particularly since the implementation of national standards in 1976. While this should enhance the attraction of mobile home ownership, it also suggests a gradual decline in the replacement demand.

Figure 5

MOBILE HOME PLACEMENTS



The quality issue was a major factor in the loss of popularity after 1972. In the late 1960's and early 1970's many new firms entered the industry, often producing shoddy products and disappearing before purchasers had a chance to seek redress. Many purchasers simply abandoned the units, resulting in a leap in the rate of repossessions by lenders. The disenchantment of both households and lenders has lingered.

The decline in the propensity toward mobile home living also reflects the perception that ownership of conventional homes represents a superior inflation hedge.

What are mobile homes like? Although the industry prefers to talk about the large multi-wide units which are purported to rival conventionally-built houses, three-fourths of mobile home shipments are single-wide units 12 to 14 feet in width shipped in one piece and containing 600 to 900 square feet of floor space. Although 75% are owner occupied, most owners do not own the land underneath. About half of mobile homes are located in mobile home parks. Only 5% are ever moved after being placed on a site.

The affordability problems facing potential home buyers, the tarnishing of the investment image of conventional housing, improved availability of long-term financing for mobile home purchases, and technological advances all suggest a favorable outlook for mobile homes. However, the mobile home industry will be swimming against the tide of demographic change. It is unlikely that unit sales will ever approach the peaks of 1971-73.

Federal Government

Direct Federal government involvement in housing falls into three general categories: rental subsidies, mortgage credit, and tax expenditures.

The rent subsidy programs, which apply to both privately and publicly owned rental housing, consists of payments to landlords of the differences betwwen the rent charged for a unit and what the subsidized tenant is presumed to be able to afford. Many of the rental subsidy programs (especially Public Housing, Section 8 new construction, Section 8 rehabilitation, and Farmers Home Administration rental subsidies) have attempted to also increase the housing supply while giving assitance to low-income subsidy recipients. This has been done by promising to provide subsidized tenants at generous rents for extended periods (up to 40 years) to developers or public housing authorities who construct new housing or rehabilitate existing housing. Generally, these subsidy agreements have been further augmented by below market rate financing, either through access to tax exempt financing or through purchases of project mortgages at subsidized yields under the GNMA "Tandem Plan".

While the efforts to increase housing supply through rent subsidies and public housing subsidies have succeeded in producing a substantial number of new units, this has been accomplished at tremendous long-term cost. The open-ended commitments to provide future subsidies are estimated by the Administration to have already reached $250 billion. The administration has proposed to eliminate virtually all subsidy commitments for new construction.

Except for GNMA Tandem Plan purchases of project mortgages at below market rates and Farmers Home Administration interest rate subsidies for home purchases by low income households in rural areas, most government mortgage credit programs consist of guarantees under which home buyers are able to borrow under more favorable terms because their debts are partially enshrouded in the risklessness attributed to government obligations. These programs do not require direct expenditures by the government, although they do implicitly have a cost to government and corporate borrowers because they preempt credit.

Several important developments are underway in these federal credit operations. FHLMC has asked congress to transform it into a private corporation like FNMA, which would allow it to expand its activities. Both FNMA and FHLMC have pilot programs or plans to guarantee passthrough securities similar to Ginnie Maes, but based on pools of conventional, rather the FHA/VA, mortgages.

The Administration has proposed cutting back the GNMA passthrough and FmHA programs and making FHA and VA mortgages less attractive. However, these popular, successful programs will probably be continued. The GNMA Tandem Plan program appears to be on the way out, however.

Tax Benefits

Several provisions of the federal income tax code provide generous support for homeownership. The primary provisions affecting owner-occupants of single family homes are:

- Deductibility of Home Mortgage Interest Payments
- Deductibility of Property Tax
- Deferral of Capital Gains
- Exclusion of $125,000 of capital gains for taxpayers 55 and older

Except for the special treatment of capital gains, these benefits are not exclusively housing-related. Taxes and interest are generally deductible.

The effect of these provisions is considerable. The Congressional Budget Office estimates that in 1982 homeowners will receive benefits of $39 billion, with 2/3 of the benefit result from the deductibility of interest 1/.

The value of the deductibility of interest increases under inflation. If inflation is at 10% and the real interest rate is 3%, producing a nominal interest rate of approximately 13%, (actually 13.3%) then for a taxpayer in a 25% bracket or above, the nominal after-tax interest rate is less than 10% and the real after-tax rate is negative. It is this phenomenon, as well as extraordinary increases in house prices and low pretax real rates, which produced the very attractive user cost of housing discussed above.

There have been recurring suggestions that the deductibility of mortgage interest rates should be eliminated or limited or that the imputed rental value of owner-occupied homes should be counted as income.

1/ Congressional Budget Office, The Tax Treatment of Homeownership: Issues and Options (Washington, Government Printing Office, September, 1981).

HOUSING FINANCE

Demand for Mortgage Credit

The fundamental factors affecting the demand for mortgage originations are the volume of new and existing home sales and house prices, plus changes in loan-to-value ratios and in the proportion of homes purchased without institutional mortgages (bought with cash, assumed mortgages, or seller financing).

Approximately 90% of home purchases involve some type of mortgage credit. In the last few years, high mortgage interest rates have caused dramatically increased use of assumptions and seller financing, reducing the value of originations relative to the value of transactions in existing homes. In the case of new homes, high mortgage rates have also brought forth various creative responses, but these have typically still involved institutional mortgage originations. The extent of creative financing is suggested by the ratio of mortgage originations to sales volume times average loan to value ratio:

Table 13
INSTITUTIONAL FINANCING
(mortgage originations relative to
sales volume times avg. loan/value)

	NEW HOMES	EXISTING HOMES
1972	95%	97%
1973	85	89
1974	87	74
1975	87	76
1976	85	86
1977	89	91
1978	90	79
1979	88	72
1980	92	55
1981	73	45

As the decade procedes, unless there are further increases in mortgage rates these ratios should increase back to the more normal 80% to 90% range. Together with increases in the number of new and existing homes sold and increases in house prices, this implies greatly increased credit demands. The need to refinance balloon-payment loans made in the past two years will also increase housing credit demands.

Table 14
MORTGAGE ACTIVITY BY MAJOR INSTITUTIONAL LENDERS
1981
(millions of dollars)

	ORIGINATIONS	PURCHASES	SALES	NET ACQUISITIONS	REPAYMENTS	CHANGE IN HOLDINGS	HOLDINGS
SAVINGS & LOANS	41,980	10,037	12,402	39,615	24,477	15,138	424,852
MUTUAL SAVINGS BANKS	4,023	245	446	3,822	4,129	-307	67,886
COMMERCIAL BANKS	20,780	2,801	4,023	19,558	12,734	6,824	153,705
MORTGAGE COMPANIES	23,826	4,360	26,715	1,471	1,114	357	7,402
LIFE INSURANCE COS.	478	159	255	382	883	-501	16,875
PRIVATE PENSION FUNDS	133	31	5	159	71	88	891
STATE & LOCAL PENSIONS	5	430	15	420	121	299	3,810
R.E.I.T'S	26	0	13	13	31	-18	0
FEDERAL CREDIT AGENCIES	4,464	12,397	7,047	9,814	3,435	6,379	70,726
STATE & LOC CREDIT	1,563	5,016	0	6,579	641	5,938	27,644
MORTGAGE POOLS	0	20,340	3,085	17,255	3,255	14,000	133,454
ALL 11 LENDERS	97,278	55,817	54,006	99,089	50,891	48,198	907,245

Source: Dept. of H.U.D.

Table 15
MORTGAGE ACTIVITY BY MAJOR INSTITUTIONAL LENDERS
1981
(percent of all lenders)

	ORIGI-NATIONS	PURCHASES	SALES	NET ACQUI-SITIONS	REPAYMENTS	CHANGE IN HOLDINGS	HOLDINGS
SAVINGS & LOANS	43.2	18.0	23.0	40.0	48.1	31.4	46.8
MUTUAL SAVINGS BANKS	4.1	0.4	0.8	3.9	8.1	-0.6	7.5
COMMERCIAL BANKS	21.4	5.0	7.4	19.7	25.0	14.2	16.9
MORTGAGE COMPANIES	24.5	7.8	49.5	1.5	2.2	0.7	0.8
LIFE INSURANCE COS.	0.5	0.3	0.5	0.4	1.7	-1.0	1.9
PRIVATE PENSION FUNDS	0.1	0.1	0.0	0.2	0.1	0.2	0.1
STATE & LOCAL PENSIONS	0.0	0.8	0.0	0.4	0.2	0.6	0.4
R.E.I.T'S	0.0	0.0	0.0	0.0	0.1	0.0	0.0
FEDERAL CREDIT AGENCIES	4.6	22.2	13.0	9.9	6.7	13.2	7.8
STATE & LOC CREDIT	1.6	9.0	0.0	6.6	1.3	12.3	3.0
MORTGAGE POOLS	0.0	36.4	5.7	17.4	6.4	29.0	14.7
	----------	----------	----------	----------	----------	----------	----------
ALL 11 LENDERS	100.0	100.0	100.0	100.0	100.0	100.0	100.0

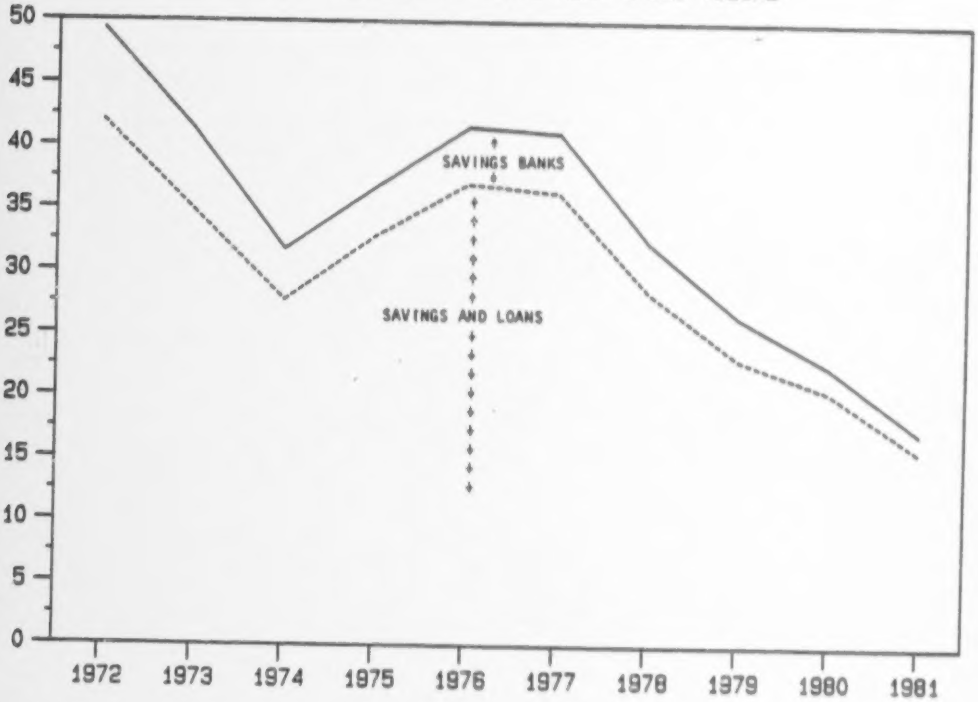
Source: Dept. of H.U.D.

Mortgage Supply

Most mortgage credit has been supplied by depository institutions, particularly thrift institutions. Tables 14 and 15 show the share each of the 11 major institutions had in mortgage lending in 1981. Although the thrifts' share of total institutional originations is down from a peak of 60% in 1976, thrift institutions continue to be the dominant element both in originations and in holdings of mortgages. However, the capacity of thrifts to provide mortgage credit from their own funds depends on the flows of deposits and the rate at which their previous mortgage investments are repaid.

Figure 6

THRIFT MORTGAGE ACQUISITIONS
AS A PERCENT OF TOTAL HOME SALES VOLUME



The decline in the ability of thrifts to provide mortgage credit has actually been greater than their share of institutional originations would suggest. S&L's, which until 1977 were net purchasers of mortgages, have now emerged as net sellers. Moreover, in the past two years a major share of housing credit has had to come from noninstitutional sources (mainly, home sellers). Figure 6, which shows the ratio of thrifts' mortgage acquisitions (originations minus net sales) to housing sales volume demonstrates the extent of the gap between demand for housing credit and the ability of thrifts to fulfill that demand.

The inability of the thrifts to fund as large a portion of mortgage originations from deposit flows as previously results from changes in the regulation of depository institutions as well as increased sophistication on the part of savers. Table 16 shows the share of deposits going to depository institutions--Savings & Loans, Mutual Savings Banks, and Commercial Banks--and money market funds.

Table 16
TIME DEPOSIT FLOWS
(billions of dollars)

	Savings & Loans	Savings Banks	Commercial Banks	Money Funds
1972	31.8	10.1	43.5	--
1973	19.9	4.9	51.6	--
1974	15.5	2.2	59.1	2.4
1975	41.9	11.2	26.6	1.3
1976	49.5	13.0	29.6	--
1977	50.0	11.1	60.6	0.2
1978	44.0	8.7	65.3	6.9
1979	38.7	3.3	45.6	34.4
1980	40.6	7.0	95.3	29.2
1981	13.3	0.5	86.3	107.5

Includes interest credited

Sources: Federal Home Loan Bank Board, National Assn. of Mutual Savings Banks, Federal Deposit Insurance Corp., Federal Reserve (Flow of Funds)

While the thrift industry will probably not be permitted to disappear entirely, it is unlikely to regain its previous vitality or protected position. Even under the most favorable of circumstances, by 1990 thrifts will probably be unable to fulfill much more than a third of mortgage credit demand.

Commercial banks have accounted for an average of 22% of insitutional mortgage originations over the past decade. They have sold more mortgages than they have purchased (excluding mortgage-backed securities), with net sales averaging 10% of originations. Commercial bank 1 to 4 family mortgage holdings have been equivalent, on average, to about 18% of their time deposits (compared to 82% for S&L's and 48% for Savings Banks). Although few bankers currently profess to find home mortgages wildly attractive, as mortgage yields rise relative to yields on other investments (see below) we expect some increase in the share of assets devoted to mortgages. Alternative mortgage instruments with adjustable rates or short maturities will comprise the bulk of the mortgages held in portfolio, since these are more in keeping with the liability structure of banks.

However, unless the home finance system continues to retreat to the nineteenth century practice of seller financing, the additional money will have to come primarily from the secondary market. Moreover, the fixed rate long term mortgage which will still be preferred by many borrowers despite higher rates is a more appropriate investment for secondary market purchasers with long term liabilities.

Mortgage-backed Securities

If the funds required to close the mortgage credit gap are to come from sources such as pension funds, private investors, and insurance companies, there will probably need to be further development or mortgage-backed securities. These non-specialized investors are not likely to find whole mortgages attractive instruments, even where the mortgages are fully or partially insured against default and where servicing is handled by originators or other specialists. Whole mortgages are still illiquid, in small non-standard denominations, and subject to erratic prepayment experience. Also, even if fully insured, delinquency or default represent something of a burden.

There are two basic types of mortgage-backed securities. Mortgage-backed bonds are standard debt issues secured by mortgages. Generally the value of the mortgages securing the debt must exceed the value of the obligation in order for the rating agencies and the markets to provide funds at attractive rates. Currently, there are about $3 billion in mortgage backed bonds outstanding, almost exclusively issued by S&L's.

Passthrough securities are more peculiar to the mortgage market. Interest payments and scheduled amortization, as well as unscheduled prepayments, are distributed to holders of securities representing shares in a pool of mortgages. Typcially, the security holders are guaranteed prompt payment even if the mortgagor defaults or is delinquent.

The premier example of passthroughs is the Ginnie Mae, which represents a share in a pool of FHA and VA mortgages, with prompt payment guaranteed by the full faith and credit of the US government. The securities are issued by private originators, GNMA's role is only that of guarantor. Currently the stock of outstanding Ginnie Maes has a face value of about $125 billion.

Another major category of passthrough is the FHLMC participation certificate, based on pools of partially-insured conventional mortgages. FHLMC is both the issuer and the guarantor of the securities. There are about $26 billion of these outstanding. Although the prompt payment of PC's is not guaranteed by the majesty of the government, only by the quasi-independent FHLMC, yields are only a few basis points more than on GNMA.

Privately issued passthroughs from banks (particularly Bank of America), thrifts, and mortgage insurance companies account for close to $2 billion worth of mortgages. These currently carry yields of 100 basis points or more above GNMA.

FNMA has recently begun to guarantee mortgage pools. Thus far, one half billion dollars worth have been issued. FHLMC has announced that it too plans to guarantee privately-issued passthrough securities backed by pools of conventional mortgages.

The potential growth of GNMA passthroughs as a source of mortgage funds is limited by the fact that only FHA and VA mortgages can be sold in GNMA pools. Anyway, the current administration is anxious to reduce the direct government role in mortgage credit guarantees. It is unlikely that passthrough securities guaranteed by private lenders or mortgage insurance companies will ever have the same characteristics of liquidity, standardization, or investor acceptance as Ginnie Maes. Moreover, the cost of insuring strictly-private passthroughs to the extent necessary to satisfy bond rating agencies is substantial.

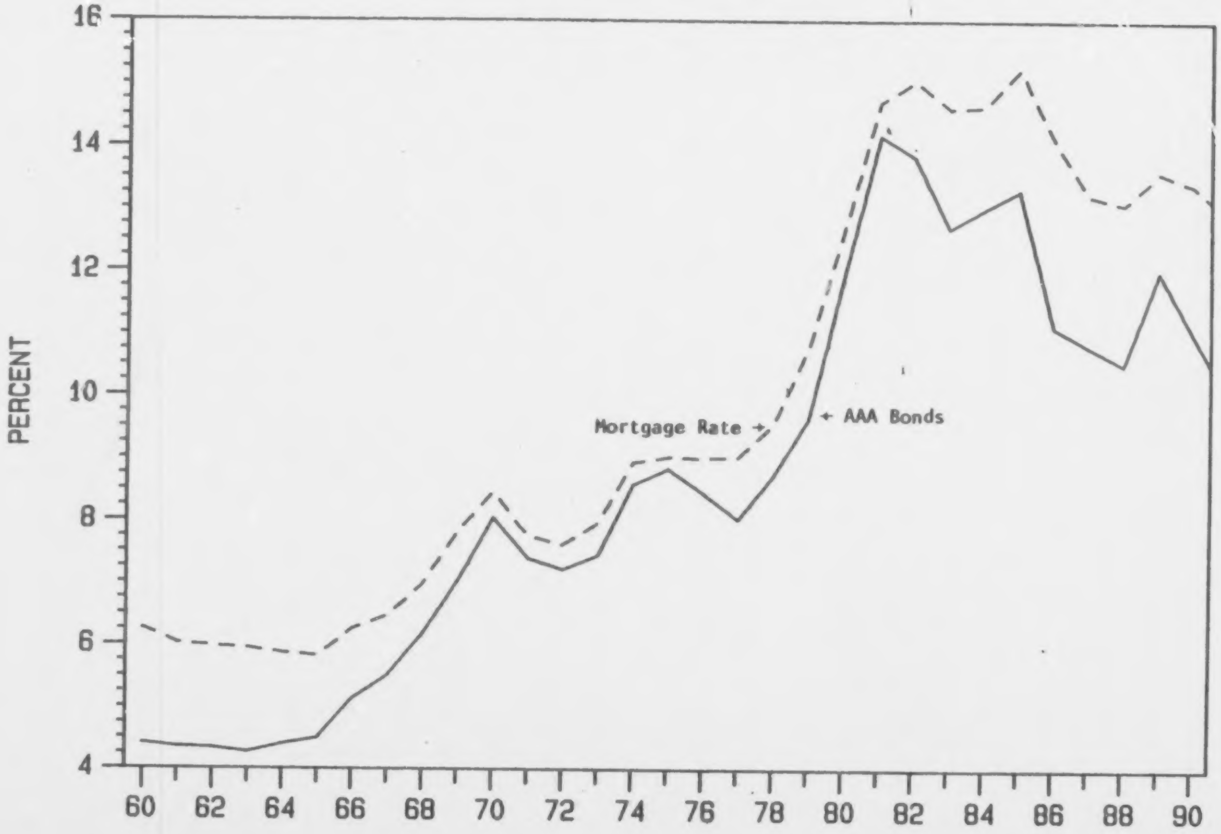
It is the FNMA and FHLMC guaranteed passthough programs which are most likely to become the primary conduit for attracting additional funds to the secondary market through mortgage-backed securities.

Mortgage Rates

Beginning in the late 1960's the price of mortgage credit shrank to only a very slight premium over the yields on high grade corporate bonds, despite the much greater administrative cost and risks (see figure 7). The narrowing of the spread between mortgages and bonds was primarily a reflection of ceilings on interest rates paid to depositors of thrift institutions, first imposed in 1965. These ceiling rates were below market rates but above the rates commercial banks were allowed to pay, producing a large, though occasionally disrupted, supply of cheap funds. The thrifts, coaxed by the carrot of tax benefits and the stick of regulation, in turn invested those funds in bargain rate mortgages. This diversion of credit resources into housing was further buttressed by the activity of the government and the federally-sponsored credit agencies, which used their superior access to credit markets to pump additional funds into mortgages. With the increased sophistication of savers and ongoing deregulation, combined with the retreat of the government from credit handouts, the system of mortgage subsidies at the expense of depositors, other borrowers, and taxpayers is coming to an end. In order for the supply of housing credit to meet the demand, the yield on mortgages will have to increase to properly reflect the administration cost and risks associated with such investments.

Figure 7

MORTGAGE RATE VS. BOND RATES



In assessing the risks of mortgages, it should be recognized that the primary risk is not one of default, as is evidenced by the fact that the default risk can be fully insured against for about 50 basis points. A more important risk is the risk of interest rate changes. All long term fixed rate investments present this risk, and thus mortgages should not be viewed less favorably than bonds for that reason. The greatest risk is the risk of adverse prepayment. The borrower has the option to prepay if rates fall, making mortgages much like callable bonds. The price of a call option is always higher where prices (rates) are uncertain of volatile, where the rate of discount is high, and/or where there is an expectation that prices will rise (rates will fall).

The importance of this call option feature can be seen by comparing the yields of Ginnie Maes with 10 year treasury bonds. Since 1972, the average spread has been 86 basis points, but recently the spread has been about 200 basis points.

Second Mortgages

One area of possible expanded activity for commercial banks is second mortgage lending, both in the form of purchase money mortgages to facilitate home purchase and loans to homeowners for home improvement or simply as a device for homeowners to extract accumulated equity.

The accumulated equity in existing homes has mushroomed as home prices grew over the past decade. The value of the existing stock has been as follows:

Table 17
HOUSING EQUITY
(billions of dollars)

	AGGREGATE VALUE	MORTGAGE DEBT	AGGREGATE EQUITY
1970	1,143	267	876
1971	1,275	293	983
1972	1,405	328	1,077
1973	1,566	363	1,203
1974	1.733	394	1,340
1975	1,934	435	1,500
1976	2,142	493	1,649
1977	2,465	579	1,886
1978	2,926	678	2,248
1979	3,488	788	2,700
1980	4,041	858	3,183
1981	4,418	907	3,511

Aggregate value based on housing stock and average existing home price. Mortgage debt data from HUD.

The capital gains accruing to homeowners have been widely credited with spurring consumption and depressing the savings rate. While some of this behavior was simply the psychological--homeowners felt they needn't save because the equity in their homes represented so much wealth--there were attempts to realize the gains.

There are three primary mechanisms by which homeowners can extract the equity in their homes: sell the house, refinance the first mortgage, or take out a second mortgage. By far the most popular method was to sell the house. In the course of selling one house and buying another, homeowners would use only a part of the equity in the previous house as a down payment on the new one. When rates on first mortgages were low and stable, refinancing the first mortgage with a larger loan made sense to homeowners who didn't want to move. Until recently, the resort to second mortgages was limited to the desperate or reckless, and it was the least popular of the three methods 1/.

Increasingly, various disincentives to housing turnover and refinancing--most especially high rates on first mortgages--make second mortgages more attractive to borrowers.

At the same time, there have been several factors increasing the capacity and motivation of second mortgage lenders. Liberalization of bankruptcy statutes has made secured real estate loans more attractive relative to unsecured consumer loans. Regulations which restricted the freedom of some lenders to make second mortgage loans have been eased. Also, a secondary market has begun to develop and mortgage insurers have begun to insure second mortgages. The aggressive entry into second mortgage lending by consumer finance companies and the greater freedom of S&L's to make such loans suggest that the competition will be fierce. If homeowners actually do begin to seek such financing, it could become an important market. Moreover, it will be difficult to maintain a role as a full service institution without becoming seriously involved in second mortgages.

1/ David F. Seiders, Mortgage Borrowing Against equity in Existing Homes: Measurement, Generation, and Implications for Economic Activity. Staff Economic Studies 96. (Washington, Board of Governors of the Federal Reserve System, 1978).

A FORECAST FOR THE DECADE AHEAD

Over the course of the decade from 1982 to 1991, we expect housing starts to average 1.8 million per year, somewhat above the 1.67 million average of the 1972-1981 decade. Moreover, due largely to the demographic changes discussed above, along with the cutback of federal subsidies for construction of rental housing, we expect the single family share to average 71%, compared to the 66% share in the last decade. This shift to single family was actually already apparent in the late 1970's. It is only the extraordinary strength of multifamily activity in the early 1970's, plus the extraordinary weakness of single family construction in 1980 and 1981, which kept the single family share down in the 1972-1981 period.

The expected strength in single family starts, plus an increase in house prices at a rate 1 to 2% above the inflation rate and a gradual reduction of non-institutional creative financing, will require originations of mortgages for 1 to 4 family homes to increase at an average annual rate of 20% from the depressed 1981 value. We expect the real mortgage rate (mortgage rate less CPI growth) to average 5%, a substantial increase from the 1 1/2% real rate in the 1972-1981 period. This is the result of an increase in real long term rates in general (real AAA bond rates averaged only 1% during 1972-1981) and an increase in the spread between mortgage rates and bond rates.

Our forecast of housing and mortgage activity is of course dependent on our assumptions about the general economy. Table 17 shows the forecast values used in our base case (most likely) forecast scenario and under somewhat more optimistic and somewhat more pessimistic sets of assumptions.

Table 18
Forecasts 1982-1991
Annual Rates

	Base Case	Optimistic	Pessimistic	Preceding Decade
	ASSUMPTIONS			
GROWTH RATES:				
REAL PER CAPITA INCOME	1.7	3.1	-0.3	1.9
CONSUMER PRICE INDEX	9.2	6.5	12.1	8.4
AVERAGE:				
AAA BOND RATE	11.8	9.7	15.7	9.3
TREASURY BILL RATE	10.6	7.2	15.8	7.8
PRIME RATE	13.2	9.5	18.0	10.1
	RESULTS			
HOUSING STARTS:(a)				
SINGLE FAMILY	1,285	1,454	871	1,104
MULTIFAMILY	533	655	356	568
TOTAL	1,817	2,109	1,227	1,672
MOBILE HOME PLACEMENTS(a)	314	381	218	322
EXISTING HOME SALES(a)	3,789	4,165	2,918	2,866
MORTGAGE ORIGINATIONS:(b)				
NEW HOMES	$124,756	137,700	86,486	38,564
EXISTING HOMES	$276,010	292,830	211,008	79,199
GROWTH RATE IN HOUSE PRICES:				
NEW HOMES	10.8	10.1	11.1	10.6
EXISTING HOMES	10.7	9.6	11.7	10.3
AVG MORTGAGE INTEREST RATES:				
COMMITMENTS: FHLBB	14.0	12.1	17.1	NA
FNMA	14.3	12.1	17.8	NA
FHLMC	13.9	11.8	17.2	10.3
CLOSINGS: FHLBB	14.0	11.9	17.1	9.9
AVG LOAN/VALUE - NEW HOMES	73.5	73.4	75.0	75.5

(a) figures in thousands of units

(b) figures in millions

Senator TOWER. Thank you.

Mr. Gourley, representing the Mortgage Bankers Association.

STATEMENT OF WILLARD GOURLEY, REPRESENTING THE MORTGAGE BANKERS ASSOCIATION; PRESIDENT, NORTHWESTERN MORTGAGE CORP., CHARLOTTE, N.C., ACCOMPANIED BY BURTON WOOD, LEGISLATIVE COUNSEL, MBA; AND SHARON CANAVAN, ASSOCIATE LEGISLATIVE COUNSEL, MBA

Mr. GOURLEY. Thank you.

Mr. Chairman and Senator Trible, my name is Willard Gourley and I am president of Northwestern Mortgage Corporation of Charlotte, North Carolina, and a mortgage banker, I have been a participant in the secondary market for the last 32 years. We welcome a lot of people's interest in the secondary market and, Mr. Dwire and Mr. Hobgood, I'm part of a bank but I'm delighted to hear more and more discussion on the secondary market.

I am chairman of the legislative committee of the MBA and with me today are MBA legislative counsel, Burton Wood; and Sharon Canavan, associate legislative counsel. We do have a rather lengthy statement that states many of the issues and I will summarize it.

Senator TOWER. It will be entered in its entirety in the record.

Mr. GOURLEY. Thank you. We appreciate the opportunity to appear before you today. I will direct my testimony to the 1983 HUD authorization legislation, as well as some other issues that affect the secondary market.

MBA has real concerns about the administration's proposed changes S. 644 in the FHA downpayment schedules for one. We also are dismayed that the administration has not gotten several messages from the Congress that the successfully operating FHA insurance and GNMA mortgage-backed security guaranty programs should not be tinkered with, and that Congress doesn't intend to permit either frontal assaults on the programs through direct phaseouts and reduced credit budget limits, or indirect attacks, such as unwarranted fees, selective targeting proposals, etc. We believe the time has come to stop this nonproductive, but time-consuming effort, and to get on with the business of housing American families and allowing housing to help lead the way out of the current economic recession.

In the same vein, MBA is concerned that the credit budget limits for the FHA and GNMA mortgage-backed security programs should be set at the same levels as those adopted for fiscal year 1983—that is, $45.9 billion for FHA and $68.25 billion for GNMA. Both FHA and GNMA are setting records in their current activity levels and are helping to lead the Nation out of the current recession. If interest rates stay at their current levels or decrease further, demand for mortgage credit will remain high and the FHA and GNMA programs should be allowed to accommodate that demand. The demand for FHA loans will increase even more if Congress enacts the proposals that would: authorize alternative mortgage instruments; increase mortgage limits for manufactured housing; liberalize loan-to-value ratios for investor-owned properties; ease requirements for condominium purchasers; and increase the ability of the private sector to develop multifamily rental housing.

These proposals will make it easier for more types of borrowers and families to buy or rent dwellings, to fashion suitable financing plans, and to seek types of homes that fit both their budget and lifestyle. MBA supports these programs as a means of making mortgage finance more affordable, as well as a further fulfillment of FHA's role as an innovator in new types of mortgage products.

MBA continues to urge Congress to free the FHA rate from any statutory maximum limitation on interest rate or discount points. This would effectively substitute the market forces of supply and demand for the current artificial restriction on interest rates, thus improving the viability of and strengthening the FHA programs. It's important that this proposal also be extended to include section 245 graduated payment mortgages, as well as any newly authorized, non-subsidized insurance programs.

MBA also supports a number of provisions in S. 644 that would encourage the private sector to invest in and develop multifamily rental housing. These proposals include: the amendments on the refinancing limits for substantial rehabilitation; alternative mortgage programs; extension of the administrative benefit of the Multi-family Mortgage Foreclosure Act to private lenders on coinsured mortgages; and the liberalization of the requirement that a purchaser in a foreclosure sale continue to operate a project in line with the program under which it has formerly been insured. All these are particularly significant dealing in the secondary market.

MBA opposes, however, the proposal to disallow tax-exempt treatment for coinsurance projects—this would remove one of the key financing tools for these projects, and would greatly reduce private sector initiative in multifamily rental development.

MBA is also concerned that these multifamily initiatives will not be able to fill the gap and provide sufficient housing for low-income households. Nor do we believe that the administration's proposed rental housing rehabilitation and housing payment certificate programs will be able to address adequately a sufficient portion of the existing need. The proposals merit further consideration and may be suitable if enacted in conjunction with a rental housing production program for those areas with insufficient supplies of housing suitable for rehabilitation.

MBA urges Congress to remove the mortgage loan purchase limitations for FNMA and FHLMC in order to maintain their ability to serve all geographic areas equally, and to give potential home purchasers access to more affordable mortgage credit via the long-term capital markets.

MBA also supports the additional asset power for FNMA. MBA also urges Congress to extend the Federal usury preemption to second mortgages. These have been very successful in the first lien side and it would be very helpful in second mortgages. These are increasingly popular in financing single family homes, as well as for multifamily developments.

In closing, I would urge the subcommittee and the Congress to keep in mind that housing, in its antirecession role, needs helpful legislative provisions, not hindering ones.

We thank you for this opportunity to testify and would be happy to answer any questions you might have.

[The complete statement follows:]

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Washington, D.C. 20005

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Mortgage Bankers Association of America

STATEMENT OF

WILLARD GOURLEY

PRESIDENT
NORTHWESTERN MORTGAGE COMPANY
CHARLOTTE, NORTH CAROLINA

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

of the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

Hearings on

S 644, "Housing and Community Development Act of 1983"

March 10, 1983

Mr. Chairman and Members of the Subcommittee, my name is Willard Gourley. I am President of Northwestern Mortgage Company of Charlotte, North Carolina, a mortgage banking company, and Chairman of the Legislative Committee of the Mortgage Bankers Association.* Accompanying me are Burton C. Wood, MBA's Legislative Counsel, and Sharon Canavan, MBA's Associate Legislative Counsel.

We appreciate the opportunity to appear before you today to testify on the 1983 authorization legislation for the Department of Housing and Urban Development (HUD) programs, S 644, the "Housing and Community Development Act of 1983." We should also like to share with the Subcommittee our views and concerns about several other important housing issues. These include the commitment ceilings on the non-subsidized, user-fee supported Federal Housing Administration (FHA) insurance and Government National Mortgage Association (GNMA) guaranty programs; removal of the limitations on loan purchases by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC); the need for a new construction program for multifamily assisted rental housing; and other housing issues.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

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MBA has deep and serious concerns about the proposed increase in the FHA downpayment schedules, which we will discuss in detail later in this testimony. We are somewhat dismayed that the Administration has not gotten several messages from the Congress that the FHA and GNMA mortgage insurance and guaranty programs are functioning as Congress intended them to—that is to serve middle-moderate- and lower-income families in their homeownership aspirations and that Congress doesn't intend to permit either frontal assaults on the programs through direct phase-outs of the programs or indirect flanking attacks, such as unwarranted higher fees, selective targeting proposals, etc., which will have an eroding effect on the programs over a period of time. We believe the time has come to stop this non-productive, but expensive and time-consuming effort, and to get on with the business of housing American families.

A second basis for our deep concern is that this disruptive proposal comes at a time when housing is performing one of its long recognized roles in the national economy, that is the vital part it plays in leading the Nation out of a recession.

ECONOMIC OUTLOOK

The Nation's economy, led by a resurgent housing sector, is finally emerging from the longest recession since the Great Depression. Increased spending on new home construction, resulting from the four percentage point decline in mortgage interest rates over the past few months, will be a strong engine of growth for the economy in 1983. MBA forecasts that housing starts in 1983 will total at least 1.4 million units, up by one-third from the 1.06 million units started in 1982. New home sales in January were up 51 percent over the January 1982 rate, the highest level for this indicator since September 1980. Sales of existing homes are also increasing as sellers offer units that had been held off the market. Loan applications, especially for FHA and Veterans Administration (VA) programs, are at all-time highs.

Many broad-based measures of total economic activity are also showing signs of recovery. The index of leading economic indicators rose 3.6 percent in January, the largest one-month gain since July 1950. Factory orders for durable goods, an important measure of the strength of the manufacturing, rose 2.4 percent in January. This is the third consecutive monthly increase and it means that the current recovery is working its way throughout the economy. Business inventories, cut sharply in the fourth quarter of 1982 by nearly $18 billion in 1972 dollars, will decline only slightly in the current quarter. This bottoming out of the inventory cycle is a major sign that the economy is on the mend. Consumer spending should benefit from the fact that consumer debt-to-income ratios are at their lowest point since the 1974-1975 recession. The average family is in shape to take on the debt necessary to finance big ticket items such as homes and autos.

The Federal Reserve's resolve to cool the inflation that peaked at nearly 14 percent in 1979 led to a consumer price increase of only 3.9 percent in 1982. Further help on the inflationary front this year can be expected from declining oil prices and burgeoning food stocks. Consumer prices should increase only four to five percent during 1983.

The economic recovery that is beginning, however, is not likely to be of normal strength and pervasiveness. Monetary and fiscal policies, operating sharply at odds since late 1979, have kept the U.S. economy in its weakest position since the Depression. Two recessions in the last three years have brought real economic output in this Nation to a point below that of 1979. Unemployment peaked at 10.8 percent in December, the highest since the dark days of 1940. Business failures in 1982 were at their highest level since the 1930s. Clearly, this is not the kind of damage that can be remedied by a few short quarters of better numbers. In order to repair the damage that the recessions of 1980 and 1981-1982 caused, it is important to take steps now to ensure stable, non-inflationary growth in the future. That is why MBA is extremely disappointed in the President's FY 1984 Budget. The fact is that the budget does not make enough meaningful cuts in Federal spending, resulting in immense deficits in each of the next five fiscal years. This failure, if unremedied by this Congress, will mean that the recovery, we see beginning, could be short-lived and terribly disruptive to our economic well-being.

The Administration is estimating a Federal deficit for FY 1984 of nearly $200 billion, following a deficit of a similar size in the current fiscal year. The amount of Treasury borrowing required to finance such a deficit is enormous. The result would be that the Federal government would absorb nearly one-half of the total new supply of credit demanded in our economy. The President's budget makes it clear that this situation is expected to continue through FY 1988. These budget projections, as well as action now being undertaken by the Congress in the area of jobs bills and other spending increases, indicate that our government is simply not facing up to the dangers of massive deficit financing.

These huge deficits would jeopardize a strong and sustainable housing and general economic recovery. With the Federal government taking such an excessive share of credit, interest rates could rise substantially. A renewal of higher interest rates, before the recovery is firmly in place, would mean even higher unemployment and business bankruptcies. Only if the Congress succeeds in reducing the Federal deficit by meaningful and substantial amounts, is there a reasonable prospect of resuming non-inflationary real growth in the American economy. It is a cruel irony that an Administration dedicated to reducing the role and presence of the Federal government in the private sector remains a pervasive giant in the Nation's credit markets.

The choices facing the Congress are not easy and all of them involve sacrifices for one or more groups. We in the housing industry are more than familiar with the sacrifices required to return to a healthy economy. Federal spending for housing and community development has been cut by over two-thirds in the past three years.

In this Congress, the next budget move should be to examine defense spending very carefully. The Nation's security is paramount, but we believe that honest and patriotic people can differ on the costs involved, and the timing of expenditures required in attaining that security.

Similarly, all of the entitlement programs that grow automatically with every upward movement in the price level should be structured so that no one group benefits at the expense of others. Only as a last resort should tax increases be contemplated. Any new tax should be structured so as to recognize the benefits of reduced marginal tax rates for business and consumer savings and investment.

These suggestions are made in a spirit of cooperation and underline the seriousness of our economic situation. The last thing that this Nation needs is a truncated recovery and a return of recession. We have already paid too high a price in terms of unemployment and lost economic output. It is our belief, however, that sizable cuts in Federal spending as the Nation's economy returns to health are the only way to assure that economic health will continue.

FHA AND GNMA-MBS COMMITMENT LIMITATIONS

Since FY 1981, Congress has imposed "credit budget" limits on the FHA mortgage insurance and GNMA-Mortgage-Backed Security (MBS) guaranty programs through the budget and appropriations processes. In FY 1983, Congress approved credit budget limits of $45.9 billion for the FHA mortgage insurance programs and $68.25 billion for the GNMA-MBS guaranty program. MBA supports these identical levels for FY 1984. S 644 makes no reference to these limits, although the HUD FY 1984 budget requests $39.8 billion for FHA and $58.65 billion for GNMA. We believe these amounts are insufficient to sustain a housing recovery.

In the first three quarters of 1982, secondary market sales of mortgages exceeded 80 percent of originations net of loans purchased under the FNMA and the FHLMC swap programs. This trend has been increasing in the past few years. In 1981, over 55 percent of all loans were sold in the secondary market.

This major trend in mortgage investment is caused by a wide variety of changes in the banking and mortgage finance industries. Financial institutions have recently won expanded powers. Institutions, which in the past have held mortgages as long-term portfolio investments, have been seriously affected by sustained high interest rates when their portfolios held low-interest rate loans. While the increased reliance on the secondary market is due in large part to adverse market conditions, it also has a number of market advantages. Mortgage-backed securities and participation certificates are liquid instruments that may be easily bought and sold. This attracts investors who otherwise would be disinterested in mortgage investments. In addition, when mortgages are pooled together, it is easier to tap into the capital markets because the securities are essentially equivalent to corporate or government bonds. The standardization present in mortgage-backed securities has also attracted non-traditional investors.

If we are adequately to address the future mortgage credit needs of this Nation, we must ensure the stability of the secondary mortgage market. The following sections highlight various aspects of that market.

FHA. In 1934, the FHA initiated the concept of the amortized, level-payment home mortgage loan backed by mortgage insurance in the event of default. Prior to the development of the mortgage insurance concept, mortgage lenders had required large downpayments to secure the property and to balance the risk, and demanded lump sum "balloon" payments at specified, short-term intervals. FHA, by pooling the risks attached to any one loan across large groups of loans, was able to reduce the potential cost of risk-taking with mortgage insurance.

There are four non-subsidized FHA home loan insurance programs: Section 203(b) for mortgages on one-to-four family units; Section 213 for cooperative units; Section 244 for co-insurance where the lender assumes a portion of the default risk; and Section 245 for graduated payment mortgages (GPM). Private lenders provide all of the funds for the mortgages. FHA simply insures these mortgages against any loss associated with a foreclosure. FHA has thus fostered a strong working partnership between private lenders and the Federal government, which has provided a steady supply of mortgage credit to moderate- and middle-income homebuyers.

Borrowers under these programs pay a mortgage insurance premium that covers the costs associated with the program. The premium income is used to pay the administrative expenses of these programs, including FHA's salaries, rent, overhead, etc. The premium income is also placed in a reserve fund, which covers foreclosure expenses whenever the proceeds of a foreclosure sale are insufficient to cover the mortgage balance. Not only do the reserve funds cover expenses and losses, but there is a mutuality feature built into these funds—if a borrower pays off the loan, a dividend will be paid from the fund to the borrower.

Not only are all expenses attributable to these programs covered by user fees, but the substantial reserve funds are invested in Treasury certificates. This provides a substantial savings, because to the extent that Government borrowings are covered by this and other similar funds, the Government is not financing its own debt in the capital markets, which both reduces the Government's cost of borrowing and makes room for other types of credit users.

GNMA-MBS Program. GNMA was established in 1968, when FNMA was spun out of HUD and accorded a private ownership status. GNMA's MBS guaranty program was initiated soon after to introduce alternative sources of capital investment into the secondary mortgage markets. The creation of the GNMA-MBS revolutionized mortgage finance by providing a highly liquid security, which attracted traditional and non-traditional investors alike.

Under the GNMA-MBS program, lenders package FHA-insured and VA-guaranteed mortgages into "pools" and sell securities based on the loans in the capital markets to investors. A GNMA-MBS pool usually consists of loans packaged in minimal amounts of $1 million. The program is a highly efficient one, which maximizes the involvement of the private lender and minimizes the Government role.

A lender will ordinarily contact a securities broker or dealer to arrange for a commitment for a GNMA-MBS at an agreed-upon amount, based on the lender's current and anticipated production of FHA and VA loans. The securities broker/dealer is responsible for securing investors willing to purchase the GNMA-MBS. Once those loans are packaged, the lender will apply to GNMA for an MBS certificate and guaranty, and issue the MBS.

A GNMA issuer is obliged to forward payments to the investor whether or not the FHA/VA borrowers have made their payments. GNMA guarantees that if an issuer is unable to forward the interest and principal to the investor in a timely manner, GNMA will make the payments to the investor on behalf of the lender.

User fees cover all administrative and default expenditures associated with the GNMA-MBS program. The fees are also accumulated in a reserve fund to cover potential default expenditures. The reserve fund is invested in Treasury certificates, and thus represents further savings to the Government, as explained previously in the discussion of FHA's operations. In fact, fee collections and other income are expected to exceed expenses by $185.7 million in 1984.

FY 1984 Credit Budget Limitations. MBA opposes setting limits on these non-subsidized, self-supporting FHA and GNMA-MBS programs. Although Congress in the past few years has imposed limits on these programs, it has been sensitive to the need to maintain a viable FHA and GNMA, so it has set these levels high enough to accommodate demand. For FY 1984, MBA proposes that the credit budget levels be set at [illegible] billion for FHA and $68.25 billion for the GNMA-MBS program. A number of [illegible] support setting the ceilings for these programs at these levels.

Traditionally, FHA mortgage insurance has been available to any potential borrower so long as the mortgage being sought fell within the maximum mortgage amount prescribed by Congress. If restrictive limits cause a shutdown of the GNMA-MBS program, not only will FHA originations be terminated, but VA loans as well. This is because the GNMA-MBS program serves as the conduit to tap into the capital markets in order to sell the majority of both the FHA and VA loans originated. In the first three quarters of 1982, nearly 85 percent of FHA and VA loans were packaged and sold in GNMA-MBS pools. In 1981, over 70 percent of FHA/VA loans were sold via the GNMA-MBS.

Other events have increased the importance of the GNMA-MBS program in the past few years. Thrift institutions, which include savings and loan associations and mutual savings banks, have in the past originated or purchased loans to be held as long-term portfolio investments. Today, the tendency is to purchase securities backed by mortgages, because these securities are liquid and may be marketed readily. This provides a certain amount of insulation from volatile interest rate swings. Recently, thrifts and banks have experienced inflows of deposit funds, due to their expanded powers, which allowed more attractive accounts to be offered. These fund inflows will allow for more mortgage investment by thrifts, but we believe, nonetheless, that the trend toward holding securities rather than mortgages in portfolio will continue.

FNMA has the authority to purchase conventional loans as well as FHA/VA mortgages. In the past year, however, FNMA has sought yields above those available through the sale of GNMA-MBSs. As a result, FNMA's purchases of FHA/VA loans have fallen dramatically, as indicated by the table below.

FNMA PURCHASES OF FHA/VA LOANS

	$ Volume (in millions of dollars)
1982	$ 901.2
1981	2,284.0
1980	5,273.3

Formerly, FNMA provided a strong market alternative for FHA/VA loans. However, since that market has virtually dried up, the GNMA-MBS program should be given high enough ceilings to provide a sufficient supply of long-term, fixed-rate, mortgage credit. While this does not indicate that FNMA will never again purchase an FHA or VA loan, it does underscore the importance of providing an adequate credit budget level for GNMA, as well as explain the upsurge in the GNMA commitments to guaranty in FY 1983.

Increases in the FHA and GNMA-MBS credit budget levels will also be necessary because of increased demand for FHA programs. When interest rates fell in September 1982, demand for FHA mortgages mushroomed, so much so that the Administration had to attach to the Continuing Resolution an emergency supplemental request of $6.1 billion for the FHA credit budget limit. HUD, in its budget proposal for FY 1984, has requested $39.8 billion for the FHA programs on the assumption that demand will have decreased by then. For a variety of reasons, MBA does not believe that this will be the case.

Applications to refinance high interest rate loans have recently accounted for approximately 30 percent of FHA applications. While this demand will slack off somewhat, MBA believes that there will still be a strong demand for refinancing funds over the next few years. Seller-financing accounted for a large volume of the loans originated over the past few years. Very often, however, that financing was not long-term, but called for a balloon payment of the mortgage balance after a specified number of years, usually three, five or seven years. These balloons will continue to mature over the next few years and will require an adequate source of refinancing funds.

The FHA has always played the role of a market innovator. S 644 proposes an authorization for several types of new experimental FHA programs. A revised multi-family co-insurance program, a shared appreciation mortgage (SAM) program for single- and multi-family homes, and an adjustable rate mortgage (ARM) program for single- and multi-family purchasers will increase the attractiveness of FHA programs and will necessitate a higher FHA credit budget ceiling than that proposed by HUD.

Most importantly, activity can be expected to increase because of the housing recovery, if interest rates remain at or near their current levels. Demand for housing has been pent-up severely for the last three years. That fact, in addition to demographic demand attributable to new household formations, is likely to keep mortgage activity at high levels. If activity levels for estimating the credit budget limits are predicated on the performance of the mortgage finance markets in the past three years, the limits will seriously underestimate demand for the programs.

New housing starts have been far below those projected as necessary to accommodate housing demand by the "baby boom" generation that is currently reaching prime homebuying age. These potential purchasers have been frustrated in their efforts to afford a home in the past few years while interest rates have been so high. Now that interest rates have abated, it is important to have available an adequate supply of home mortgage credit if the housing needs of these families are to be addressed. In our estimation, at least 1.8 million housing starts per year will be necessary to fill that need. In the past three years, housing starts have fallen far below that threshold. While it may be difficult to build and finance enough homes to make up for the past few years, it is important to ensure that mortgage credit is not artificially restricted and mortgage costs increased so as to impede the effort to gear up and at least approach the projected necessary annual levels of new housing production.

Congress should be careful not to overestimate the capacity of the suppliers of conventional funds to provide sufficient volumes of long-term, fixed-rate mortgage funds as have been provided in past economic post-recession periods. The current shakedown period in which the markets are evolving should be handled carefully so as not to create shortages of mortgage credit at a time of unprecedented demand.

MBA also urges Congress to monitor carefully the status of commitment activity under both the FHA and GNMA-MBS programs, so that it can adjust the ceilings higher if that becomes necessary, and to include language to prevent the impoundment of credit budget commitments.

REMOVAL OF MORTGAGE LOAN PURCHASE LIMITS FOR FNMA AND THE FHLMC

MBA urges Congress to remove the maximum mortgage loan purchase limits currently imposed on FNMA and the FHLMC.

Currently, FNMA and the FHLMC may not purchase loans with balances greater than a legislatively determined maximum dollar amount. Although the purchase limit is indexed annually, the current limit of $108,300 effectively excludes many potential FNMA and FHLMC purchases in a significant number of high cost areas. FNMA and the FHLMC package many of the loans they purchase as securities to be sold to capital market investors and higher balance loans would be acceptable as collateral behind FNMA- and FHLMC-issued securities.

FNMA and the FHLMC have both shown a commitment to provide a source of mortgage credit for a wide range of loans—both as to type and dollar amount. The average loan amount of their purchases is significantly below the maximum purchase limit. Nonetheless, in order to maintain the ability of FNMA and the FHLMC to serve all geographic areas equally, and to expand the markets for larger balance loans that have become so prevalent in today's housing market, these restrictions should be removed. The secondary market is playing an increasingly dominant role in providing sources of investment capital for mortgage finance. Therefore, it is imperative that FNMA and the FHLMC be allowed to expand their operations to address the finance needs of purchasers with high balance mortgages. Potential home purchasers must rely more than ever on access to long-term capital markets provided by institutions such as FNMA and the FHLMC, because thrift institutions are no longer providing adequate sources of long-term mortgage capital.

In order for FNMA and the FHLMC adequately to serve the needs of all home purchasers, the purchase limitations should be removed. This would give purchasers of higher priced homes access to competitive financing in the capital markets, allowing them, in turn, to sell their lower priced homes to families with lower incomes.

PREEMPTION OF USURY FOR SECOND MORTGAGES

MBA urges the Subcommittee to provide a Federal usury preemption for mortgages secured by a second lien on residential real estate, in the same fashion as Congress enacted the Federal usury preemption, which now protects first lien mortgages from restrictive state usury laws.

The demand for second lien mortgage loans has increased dramatically in recent years. From a market share of 5 percent in the mid-1970s, second lien mortgages had expanded to 40 percent of the market in 1981 by a recent estimate in U.S. Housing Markets, a publication of Advance Mortgage Corporation, Southfield, Michigan. (See: "Seconds, A Snowballing Market," Walter P. Blass, Mortgage Banking, February, 1983, pp. 25-30.) The study estimates that when activity for 1982 is fully reported, second lien activity by all types of lenders will have sustained the volume of approximately $19 billion originated in 1980. MBA's survey of mortgage banking companies concluded that mortgage bankers originated $735 million in second mortgage loans in 1981, the last year for which data is available, compared to $244 million in 1979.

The rapid increase in second lien mortgage lending comes from increased use of such mortgages to facilitate first lien transactions and from a desire of homeowners to borrow against their equity without paying off the existing first mortgage. More and more buyers are forced to use second mortgages in purchasing a home because the appreciation of house prices has exceeded the family's ability to save for a substantial down payment even though the buyers may have sufficient income to meet both first and second mortgages. In situations where existing first liens carry high prepayment penalities or carry interest rates much lower than current rates on new loans, second mortgages provide a means by which the homebuyers can "refinance" his mortgage investment without disturbing the first lien.

Second mortgages are also used to provide rehabilitation and repair of existing residential real properties. This is especially true in multi-family housing projects. More and more, it has become clear that as housing becomes more expensive, people are moving less, buying fewer "new" homes, and instead, are repairing what they own. A second mortgage usury preemption would facilitate such a national rehabilitation effort.

This is especially important for the elderly and retired persons who have lived in their home for decades and whose first mortgage is substantially paid down, but who need funds to rehabilitate their life long investment.

Second mortgages are also used extensively in large multi-family housing project developments where several lenders are involved. A second mortgage preemption would also facilitate new multi-family rental housing, which has, as a percentage of new building, been decreasing rapidly over the last decade.

Responding to and encouraging the increased market demand for financing based on home equity that does not disturb an existing, favorable-rate first lien mortgage, FNMA entered the secondary market for second lien mortgages in late 1981. When FNMA began to make commitments to purchase second lien mortgages at yields only 1/4 percentage point higher than yields it required on first lien mortgages, a new depth was brought to the secondary market for second mortgages. Not only is FNMA's activity helpful to mortgage originators who sell to FNMA, but the presence of FNMA in the market has provided reassurance for other lenders to enter the second lien mortgage business.

In enacting Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), which preempted state usury laws for first lien mortgages, Congress recognized that anachronistic state legal limits on interest rates and discount points were impeding the operation of the nationwide mortgage market, and preventing the equal flow of mortgage credit to the Nation's citizens. Concerned lest the rights of the states be unnecessarily preempted, Congress allowed each state until April 1, 1983 to act to reimpose usury ceilings. To date, only 13 states have chosen to act to reassert jurisdiction over interest rates on first lien mortgages, and none of them has acted in a manner significantly detrimental to the market.

The impediments which interfered with the nationwide market for first mortgage financing continue to interfere with second mortgage borrowing. Eighteen states specifically limit second mortgage rates; the remaining states have a variety of laws restricting borrowing charges. As with first mortgages, such laws should be set aside, with, of course, the authority reserved to the states to reconsider imposing usury limits if any wishes to do so.

1983 AUTHORIZATION LEGISLATION FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PROGRAMS

The Administration's proposals provide for funding authorizations for housing and related programs for HUD, as well as program extensions, and are embodied in S 644, the "Housing and Community Development Act of 1983."

Following are MBA's recommendations with respect to various sections of the proposed legislation.

LOW INCOME HOUSING

Section 102 would authorize a new Rental Rehabilitation program designed to work in conjunction with the proposed Section 8 Housing Payment Certificate (HPC) program found in Section 204. Proposed funding at $150 million would be allocated on a needs basis to local and state governments that can make the funds available to multi-family project owners willing to match those funds to rehabilitate their projects. This proposal would replace the Section 312 rehabilitation program and the Section 8 moderate rehabilitation program.

MBA has serious concerns regarding aspects of Sections 102 and 204. First, the funding level proposed is insufficient, even considering that it is designed to leverage matching funds. Second, the formula for determining projects eligible for assistance will tend to concentrate these projects in depressed areas. Third, the HPC is not attached to the unit. If a tenant chooses to exercise the option allowed under the program to take the HPC and go elsewhere, MBA has real concerns for the continued financial soundness of the project. It may be extremely difficult to attract non-subsidized tenants to a project principally occupied by subsidized tenants, even though the performance standard on after-rehabilitation rents requires project rents to be in line with fair market rents in the area.

Localities or states participating in this program will need to be quite sophisticated to perform the neighborhood analyses required by the performance standards. We fear, therefore, that only the governments with sophisticated resources will be able to compete successfully for the very limited funding. While this may make sense from a marketing and financial soundness viewpoint, it will not target funds to many less sophisticated localities, whose housing needs may be just as great or greater. Furthermore, the program can help only those communities that have a stock of housing that is suitable for rehabilitation—if the housing stock is beyond repair considering the financial restraints, or a supply of multi-family housing simply does not exist, this program will do nothing to address those needs. A multi-family production program for new construction must be developed to address housing needs in these situations.

MBA believes a program to assist the construction of multifamily rental housing, administered by HUD, is necessary to provide an adequate supply of rental housing in those areas of the country experiencing low vacancy rates. MBA urges Congress to enact a multi-family rental housing production program as part of the 1983 HUD authorizing legislation.

EXTENSION OF FHA MORTGAGE INSURANCE AUTHORITY

Section 301 would extend the insuring authority for most of the FHA programs for two years.

MBA supports the two year extension. Congressional practice for the past few years has been to provide for a one year extension. MBA urges this Subcommittee and the Congress to enact the two year extension of these programs as provided in Section 301 so as to diminish the possibility of FHA's insuring authority from lapsing and disrupting the markets, as has occurred in the recent past.

SECTION 235

Section 301 does not extend the Section 235(i) home ownership assistance program for lower income families.

MBA supports an extension of this program and urges a modest level of funding for this program for FY 1983. The Section 235(i) program is a useful, efficient means of providing homeownership assistance to low-income families that has worked well in the past.

PROPOSED ELIMINATION OF INSURING AUTHORITY FOR NURSING HOMES AND HOSPITALS

Section 301 does not include extensions for the FHA Section 232 nursing home and the Section 242 hospital insurance programs. The rationale propounded by HUD is that the private market can meet these financing needs for both nursing homes and hospitals, and, further, that only a very limited need exists for financing hospitals. This is simply not the case.

MBA urges the extension of authority to insure under the FHA Section 232 nursing home and Section 242 hospital programs. Insurance written under these programs has provided a worthwhile and necessary source of financing for nursing homes and hospitals that are, for the most part, located in urban and rural areas. This has not resulted from any intentional targeting, but rather, because private entities have not provided financing in these areas where profits will not be as high as elsewhere. A much higher proportion of the patients in projects insured under Sections 232 and 242 are Medicare and Medicaid recipients than in most privately financed projects. Many of FHA-insured nursing homes and hospitals offer free or reduced-cost care, because they are located in areas where the patients are largely from low-income families. Obviously, this community oriented service cuts into profits. In fact, many of these projects are owned and operated as non-profit institutions by religious or other community oriented organizations. This health care would not be available without federally insured financing, which serves to lower interest costs and ensure that financing can be secured.

The Section 232 and 242 programs are not subsidized and are actuarially sound. Without the availability of these programs, many of these projects either would not be viable, or if financed, would cost more. Ironically, much of the potential added cost would be picked up by the Federal government, because so great a percentage of the patient population in these nursing homes and hospitals qualify for Medicare and Medicaid.

FHA CO-INSURANCE

Section 301(h)(1) would also eliminate the current limit on the amount of mortgages that may be insured by FHA on a co-insured basis.

MBA supports this provision. Implementation of the proposed multi-family co-insurance program will spur demand, and this limitation should thus be removed.

HUD RESEARCH

Section 203 provides $18 billion in funding for HUD research.

MBA recommends funding of research at this level.

FREE FHA/VA INTEREST RATE

Section 306 would allow mortgages insured under most FHA programs to bear an interest rate and discount points agreed upon by the borrower and lender.

MBA supports this section. Under current law, the maximum interest rate allowable on a mortgage insured by the FHA is fixed by the Secretary of HUD. Customarily, the VA follows HUD's lead and sets the same maximum rate for VA-guaranteed mortgages. In the early 1950s, Congress enacted legislation to fix interest rates and to ban discount points. The result was a collapse of the FHA/VA portion of the mortgage market, and the law was repealed.

The setting of a maximum interest rate by the HUD Secretary harkens back to an earlier era in America's financial history when residential mortgage markets were highly localized and sometimes dominated by a few suppliers of mortgage credit. Possibility for abuse existed, and the Federal government, in the FHA and VA mortgage insurance and guaranty programs, acted in a fashion similar to state governments and set maximum interest rate ceilings. This Federal and state system of interest/usury ceilings was not a problem as long as market rates remained below the ceilings. However, the volatility of interest rates in the latter part of the 1970s turned this restrictive system of interest rate limitation, into a hangman's noose around the neck of the housing and mortgage finance industries.

Congress recognized this, at least as far as state mortgage usury ceilings were concerned, and preempted those laws as part of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221). MBA believes the time has arrived for Congress to complete the task of reforming the law by repealing all artificial restrictions on interest rates for FHA and VA mortgages.

The Federal preemption of state usury ceilings has been in force for three years. Only a handful of states have overridden the preemption. To date, there have been no widely reported and documented instances of abuse or charges of substantially above market interest rates by mortgage lenders. As we maintained to the Congress in testimony on this issue in 1979 and prior years, the market forces of supply and demand, together with the national linkage of all local mortgage markets, ensures that no single lender or group of lenders in any locality or region could demand and receive mortgage interest rates substantially above the market rate. The same is true for FHA and VA loans.

MBA urges Congress to free the FHA rate from any statutory maximum limitation and to allow all FHA-insured mortgages to bear an interest rate and points as agreed upon by the borrower and the lender, without any maximum set by the HUD Secretary. Adoption of a free FHA interest rate would effectively substitute the market forces of supply and demand for the current artficial restriction on interest rates for FHA-insured loans, and would improve the viability of the program.

Section 306 does not extend the free FHA rate to the Section 245, graduated payment mortgage (GPM) program. MBA believes that Section 306 should cover this as well as any newly authorized insurance programs, unless the programs are specifically designed to be subsidized programs where HUD must protect its funding interests and impose interest limits. GPM borrowers do not need to be singled out for interest rate protection and MBA urges that this program be included under Section 306.

The Housing and Community Development Act of 1980 (P.L. 96-399) authorized the HUD Secretary to set up a negotiated interest rate demonstration program for FHA-insured mortgages. The negotiated interest rate program, implemented by HUD this past year, has proven to be a success. The limits imposed under the demonstration program are about to be reached, however. In our judgment, a free FHA rate is clearly superior to the negotiated rate alternative. Until the free FHA rate is adopted, however, we would urge Congress to remove the limit on the number of loans eligible for participation in the negotiated rate program.

This points out the difficulties and complications that result when Congress attempts, through legislation, to impose artifical restrictions on free market transactions that take place in a volatile environment. We urge Congress to enact Section 306 and remove all interest ceilings on FHA-insured loans.

MULTI-FAMILY MORTGAGE FORECLOSURE

Section 307 would remove the requirement that under certain circumstances, any purchaser of a multi-family project acquired under the Multi-family Mortgage Foreclosure Act of 1981 must continue to operate the project in accordance with the programs under which it had previously been insured. The section would leave the HUD Secretary with authority to make such a requirement a condition with regard to any project the Secretary determined to be appropriate for such treatment.

MBA urges adoption of Section 307. Expanding the discretion given to the Secretary will increase the efficiency with which the Multi-family Mortgage Foreclosure Act can operate, while at the same time protecting the interests of tenants in appropriate cases.

MORTGAGE INSURANCE PREMIUM

Section 308 would amend the pertinent sections of the National Housing Act to increase the single family maximum mortgage amount by the amount of the up front mortgage insurance premium (MIP) soon to be required. The change is designed to implement the decision made by Congress in P.L. 97-253, the 1982 Omnibus Budget Reconciliation Act, to permit single, up front FHA mortgage insurance premiums to be collected at the same time the loan is closed, and to be added to the allowable maximum mortgage amount irrespective of whether that amount results from the dollar amount of the loan or from the loan-to-value ratio. The proposal would allow the loan-to-value ratio to rise above 100 percent in those instances where borrowers made the minimum downpayment.

Section 308(c) retains the protective language of the existing law dictating that the upfront premium provision may be implemented only if it does not threaten the actuarial soundness of the FHA programs.

MBA supports the technical amendments embodied in this provision.

FORECLOSURE UNDER THE MULTI-FAMILY COINSURANCE PROGRAM

Section 309 would allow private lenders who have coinsured multi-family mortgages to foreclose such mortgages when they are in default, with the authority now reserved only for the HUD Secretary to ignore inhibitive state laws pursuant to the Multi-family Mortgage Foreclosure Act of 1981. The section would continue the requirement that the Secretary be the guarantor of any misconduct on the part of the foreclosure commissioner appointed to conduct the foreclosure under the act.

MBA supports Section 309. Allowing the coinsured lender to initiate and conduct the foreclosure procedure under the Multi-family Foreclosure Act will reduce delays and costs which must ultimately be absorbed by the FHA insurance programs.

It is not clear from the section that the coinsuring lender will be held harmless for claims not based on willful or gross negligence, or misconduct of the coinsuring lender. Clarifying that a careful lender will not be held responsible for claims from third parties would increase the effectiveness of the section.

MANUFACTURED HOUSING

Section 311 increases the maximum loan limits for manufactured homes and lots. Section 312 authorizes refinancing for manufactured homes.

MBA supports these provisions. Manufactured housing offers a viable, affordable housing option to low- and moderate-income families, and we encourage greater opportunities for this type of housing. MBA believes that manufactured housing should not be discriminated against so long as it meets the National Manufactured Housing Construction and Safety Standards.

FHA DOWNPAYMENT

Section 313 would amend the downpayment requirement for the FHA Section 203(b)(2) program. The proposal would require a 3 percent downpayment for the first $50,000 of a mortgage and 10 percent for the balance up to the FHA maximum. Currently, FHA requires a downpayment totalling 3 percent of the first $25,000 and 5 percent of the balance.

MBA strongly opposes this change, as we noted at the beginning of our testimony. This change will decrease the downpayment to a moderate-income homebuyer by no more than $500, while increasing downpayments by as much as $1500 for homes priced up to the FHA high-cost area maximum. The change makes no allowance whatsoever for regional price differences. While purporting to ease requirements for "moderate-priced dwellings," the proposal simply sets an arbitrary limit of $50,000 to qualify for the 3 percent downpayment. While $50,000 may cover a modestly-priced dwelling in some regions, in other areas this would purchase a more luxurious home. In high-cost areas, virtually no homes would fall within this range. Increasing the downpayment requirement for mortgages over $50,000 thus discriminates against principally urban and suburban moderate-income homebuyers who, by happenstance, live in high-cost areas.

Furthermore, MBA has serious concerns regarding the impact of this proposal, if adopted, on the actuarial soundness of the FHA mortgage insurance funds. Loans on homes priced at the lower end of the scale are often riskier mortgages, for a variety of reasons. The homes are usually located in communities where prices are not appreciating at the same rate as higher-priced, or newer neighborhoods. Appreciation in a home's value reduces the risk to the mortgage insurer—in this instance, FHA. First, if the home has appreciated substantially, the borrower will try to protect the additional value represented by appreciation and paid-in equity. Where the borrower defaults, there is a greater likelihood that the borrower will attempt to sell the home to protect his or her financial interest and recoup the added value. In the event that the mortgage on the home is foreclosed, and FHA must pay on a claim, if the home has appreciated in value and can be sold to cover the mortgage balance plus foreclosure costs, FHA suffers no loss.

Where the home has not appreciated, or in instances where the borrower has little or no equity, there is no incentive to avoid default and foreclosure. If FHA insures more homes where this situation might exist, then the FHA can expect to pay more claims than it does presently.

The current claims rate for the Section 203(b) program is 6.9 percent, while the loss ratio is 51.6 percent. This means that of the loans originated in a given year, lenders will present a claim for payment due to a default on 6.9 percent of those loans and that HUD will make a final payment to resolve those claims totalling an average of 51.6 percent of the mortgage balance. If FHA moves towards riskier loans, then not only will there be a real possibility that the claims rate itself will increase, but also that the loss ratio will skyrocket. This could have a devastating impact on the actuarial soundness of the Mutual Mortgage Insurance Fund.

This is particularly true if prospective borrowers on higher-priced homes, which can be expected to appreciate faster, do not choose the FHA insurance option because its chief attraction—the low downpayment—has been removed. Not only would the FHA insurance funds suffer from potentially greater losses on riskier properties, but the insurance funds could no longer attract premiums from loans on less risky properties.

MBA is also concerned that when this provision, if enacted, is combined with the option offered to include the up front FHA mortgage insurance premium (MIP) in the mortgage amount, more loans will carry loan-to-value ratios up to 100 percent of the home's value. This could further exacerbate the potential risk to the actuarial soundness of the FHA insurance funds. In light of the fact that there has been insufficient time to analyze the impact of the yet-to-be-implemented up front MIP, MBA cautions against moving too rapidly to a system that would increase the number of FHA homes that would be insured at 100 percent of their purchase price.

The FHA non-subsidized program has operated on an actuarially sound basis for nearly 50 years. MBA opposes this proposed change in the downpayment schedule because of its potential to alter the actuarial soundness of the insurance funds, and turn these programs into programs that not only would not pay their way, but might cost the Federal government money because of increased claims.

NON-OWNER OCCUPIED SINGLE FAMILY MORTGAGES

Section 314 would amend current mortgage limits on single family FHA-insured mortgages on non-owner occupied homes. The amendment would set mortgage limits for investor-owned dwellings at the lesser of 85 percent of the loan-to-value ratio or the same dollar amount limits as for owner-occupied dwellings.

MBA supports this provision. It will encourage an increased supply of moderately priced rental housing by providing a more flexible means of financing for owners of rental housing. This proposed amendment complements the changes in depreciation that Congress enacted, as part of the Economic Recovery Tax Act of 1981 (P.L. 97-34), which permit newly acquired residential rental housing to be depreciated over a maximum 15 year period. This relatively short depreciation period encourages investment in residential rental housing and the proposed amendment will complement that encouragement.

INCREASE IN MORTGAGE INSURANCE PREMIUMS

Section 315 would authorize the HUD Secretary to charge different insurance premiums for riskier programs, than would be charged for fixed-rate, level payment FHA-insured mortgages. Section 315 would authorize the Secretary to charge an insurance premium on a program-by-program basis, up to three percent per annum. The across-the-board maximum premium permitted under current law and for the past 50 years, has been one percent per annum.

MBA strongly opposes Section 315. The Mutual Mortgage Insurance Fund, which has been operating on an actuarially sound basis, is solvent and has significant reserves at the present time. Past collection of mortgage insurance premiums, therefore, show no justification for an increase to three percent.

MBA recognizes that experimental mortgage programs may initially require higher premiums than fixed payment mortgages, because they appear to be riskier and because there is little or no actuarial experience to establish an anticipated claims rate. If the Administration has in mind some new program not currently covered by the Mutual

Mortgage Insurance Fund, the request for additional premium authority should be explicitly tied to that program, and the request for authority for programs should not be made in the abstract.

There are other insurance funds under the FHA insurance programs, such as the General Insurance Fund. These were not intended to be operated on an "actuarially sound basis," but only on an "economically justifiable basis." These were not intended to be supported totally from insurance premiums, and if a change in the basic concept of these non-actuarially sound funds is needed, HUD should request specific and clear changes.

PAYMENT OF CLAIMS WITHOUT HUD ACQUISITION OF TITLE

Section 317 would authorize HUD to pay single family claims without acquisition of title to the property when the mortgage is in default. Under current law, HUD must acquire title to each property subsequent to a claim, must care for the property, and ultimately must dispose of it. The administrative burden on HUD of managing acquired properties has been great.

MBA supports this provision. To the extent private interests believe they can economically recycle foreclosed property, as indicated by their bids at foreclosure, they should be allowed to do so, and HUD should be freed of this costly administrative burden.

DISCRETIONARY RENT REGULATION

Section 318 would grant the Secretary discretionary authority to regulate rents in FHA-insured, unsubsidized, multi-family rental projects, rather than mandate such regulation as current law provides.

MBA supports this authority for the Secretary. Rent control, no matter what level of government imposes it, is a substitution of artificial price levels set by government fiat for the free market forces of supply and demand. The distortion that results inevitably works to the detriment of the tenants because the incentive for owners to maintain their rental projects is diminished, and potential investors are discouraged from investing in either existing or newly constructed rental housing.

MANUFACTURED HOME PARKS FOR THE ELDERLY

Section 319 would amend current law to permit the insurance of manufactured home parks designed exclusively for the elderly.

MBA supports this limited exception to the current rule that requires borrowers to certify that they do not discriminate against families with children. Manufactured rental housing affords the elderly decent, sanitary accommodations at a reasonable cost. Manufactured home parks designed exclusively for the elderly can incorporate a number of design features that would have little or no appeal to families with children. MBA believes mortgage insurance should be available for these types of home parks.

REFINANCING FOR SUBSTANTIAL REHABILITATION

Section 320 would amend the limits on mortgages for substantial rehabilitation of multifamily rental properties with existing FHA-insured mortgages.

MBA supports this provision as a means of promoting the rehabilitation of existing multifamily rental housing and upgrading the Nation's rental housing stock. The current limit is 90 percent of the sum of the estimated cost of repair plus the existing indebtedness. Section 311 would change the existing indebtedness portion of the formula to the value of the property before rehabilitation. This provision could prove particularly useful in those cities with a rental housing stock that is basically sound, but in need of rehabilitation, by offering owners, who have maintained their properties and thus preserved the value, a more flexible means of financing the rehabilitation and refinancing the existing debt.

ASSIGNMENT OF SECTION 221(g)(4) MORTGAGES TO GNMA

Section 321 permits lenders to assign Section 221(g)(4) mortgages directly to GNMA rather than HUD.

MBA supports this provision, because it reduces administrative red tape by bypassing the assignment to HUD, which must then reassign the mortgage to GNMA.

SECTION 221 BUY-BACK

Section 322 amends Section 221(g)(4) to eliminate the "buy-back" feature of the program, which currently permits lenders in the 20th year of a loan to exchange the mortgage for debentures at the market rate for the outstanding loan balance.

MBA opposes this provision. Section 221(g)(4) assists in attracting investors in HUD insured project mortgages. This 20 year buy-back provision also benefits HUD, because investors are willing to pay higher prices for project loans being sold in the GNMA project loan auctions. If the loan has the 221(g)(4) provision, this gives investors the option to seek a buy-back or allow project loans to run for a longer term, and they will thus pay more for this option.

MORTGAGE INSURANCE FOR CONDOMINIUMS

Section 323 would eliminate the conditions contained in current law that must be met before HUD may insure mortgages on individual condominium units, and simply permit mortgage insurance on a condominium unit in a project that has been approved by the Secretary.

MBA supports this provision as facilitating the use of FHA mortgage insurance for the acquisition of condominium units. This provision will permit FHA better to serve moderate-income homebuyers, who make up a substantial percentage of all condominium purchasers, by making FHA mortgage insurance more readily available for condominium purchases.

ALTERNATIVE MORTGAGE INSTRUMENTS

Graduated Payment Mortgages (GPMs).

Section 324 would amend existing authority for HUD to insure GPMs by consolidating existing sections and extending GPM authority to multi-family mortgages.

MBA supports this provision. The proposal deletes the "credit elsewhere" and "first-time" homebuyer requirements, both of which are administratively burdensome to satisfy. The provision also removes the restriction on how many GPM loans may be originated. The GPM program has been a great success in making mortgage credit affordable, and these changes will expand these opportunities to more families.

MBA supports extending GPM authority to multi-family projects. Because there are no proposals in S 644 for a multi-family new construction rental housing program, the private sector should be given as many alternatives for financing this type of property with the hope that private financing can affordably support production of new units.

Adjustable Rate Mortgages (ARMs).

Section 325 would authorize single family ARMs.

MBA supports an authorization for an FHA ARM program. The proposed interest rate adjustment "cap" is too restrictive, however, and will inhibit use of the program. MBA proposes that more than one plan be developed, so that borrowers can choose a financing mechanism tailored to their means, and so that lenders can price the various interest adjustment methods according to the interest rate protection accorded to the lender.

Shared Appreciation Mortgages (SAMs).

Section 325 authorizes an FHA SAM program for single-family loans. Section 327 authorizes an FHA SAM program for multi-family projects.

MBA supports both Sections 326 and 327. While we do not believe that there will be much demand for a single family SAM program, based on the lack of interest in private efforts to frame such a plan, a nationally implemented FHA program might spur more interest.

For multi-family projects, SAM mortgages will be extremely useful. Many income property project mortgages currently require equity participation by investors, so this section will expand investor interest. Again, whatever programs that Congress enacts, which can expand private financing in the multi-family area, will provide a much needed boost.

We suggest, however, that the SAM provisions be amended to permit lenders to receive a percentage of any proceeds that remain from a foreclosure sale after the existing mortgage is paid off and the owner is reimbursed for the downpayment, equal to the lender's percent of appreciation specified in the SAM. We agree that no type of FHA insurance coverage is possible for the lender's portion of anticipated appreciation. In the event, however, of a foreclosure and sale, the borrower has already had the benefit of the agreement they made with the lender in the SAM, namely a below market interest rate. It is only equitable that if there are excess proceeds that a percentage of those proceeds should be paid to the lender in return for the benefit that the borrower has already enjoyed.

Further, we suggest that flexibility be granted the Secretary with respect to the percent of FHA-insured mortgages that could be ARMs or SAMs. While the proposed limits on the number of loans 125,000 and 50,000, respectively, should prove sufficient, it is possible that these mortgage types could become extremely popular and, therefore, suggest that the Secretary be permitted to increase these limits by 15 percent, should circumstances so warrant.

Home Equity Conversion for Elderly Homeowners.

Section 328 authorizes a demonstration program to allow elderly homeowners to convert the equity in their homes to annuity payments.

MBA supports this provision as another means of adapting to the financing needs of borrowers. The extremely limited nature of this demonstration program with a limit of 1,000 mortgages will be unlikely, however, to produce any meaningful conclusions, even if the program is geographically targeted.

TIME OF PAYMENT OF PREMIUM CHARGES

Section 330 would clarify that Section 530 of the National Housing Act, which requires prompt remittance of mortgage insurance premiums on a monthly basis, applies only to single-family mortgages.

This has been MBA's understanding since Section 530 was enacted and we urge Congress to make this clear by enacting Section 330.

MORTGAGE INSURANCE FOR INDIAN RESERVATIONS

Section 331 authorizes FHA to insure mortgages on Indian reservations and Hawaiian home lands.

MBA supports extending FHA insurance for Indian and Hawaiian properties that are subject to unique claims, which affect marketability. In light of the increased risk, MBA supports insuring these mortgages under the General Insurance Fund.

HOUSING COUNSELING ASSISTANCE

Section 332 would eliminate all funding for grants under the Housing Counseling Assistance Program.

MBA opposes this elimination, because we believe that housing counseling is a prudent means for HUD to safeguard the integrity of the FHA insurance funds and for the Federal government to safeguard its investment in housing assistance and mortgage insurance. We urge Congress to fund this program, even if at a reduced level, to continue this relatively inexpensive safeguard.

PROHIBITION OF THE USE OF TAX-EXEMPT FINANCING IN CONNECTION WITH FHA CO-INSURANCE

Section 333 would amend Section 244 to disallow tax-free treatment for co-insurance loans financed via tax-exempt obligations.

MBA opposes this provision. HUD has only recently proposed a new multi-family coinsurance program to activate investor and developer interest both in construction of new multi-family projects and refinancing existing multi-family projects. Now that these new programs are about to be inaugurated, the ability to use one of the primary financing tools—tax-exempt bonds—is about to be eliminated. There is no multi-family production proposal in this bill. The multi-family coinsurance programs, in conjunction with tax-exempt financing, where feasible, make it possible for the private sector to deliver multi-family housing.

Thank you for the opportunity to testify. I will be happy to answer any questions you may have.

Senator TOWER. Thank you very much, Mr. Gourley. That completes our panel presentation and we will proceed to questions. Each member will be limited to 10 minutes.

Mr. Thygerson, while many of your proposals are similar to FNMA's, the major difference occurs in your not requesting the broader asset power. Did you consider such a request and, if so, why aren't you making the same request?

Mr. THYGERSON. We did consider an expansion of powers beyond the real estate field. Our position is that we have all we can do to operate within the real estate market and all of the proposals that we have submitted to the committee are clearly consistent with the Charter Act authority.

I must confess to having my own ideological position on matters like this. When I was in graduate school I wrote a dissertation on the impact of Federal agencies in the capital markets. One of my concerns at that time was that these entities use their special advantages, in terms of financing their operations, very carefully in the market place.

I have spent the last year and a half in the private marketplace working for a savings and loan. One of the things that we were trying to do at that time was to use all of our ingenuity to attract money and then compete for short term assets. In particular, we were interested in obtaining consumer loans, construction loans, anything that would be a good match for our liabilities.

I must be careful at the Federal Home Loan Mortgage Corporation not to make it more difficult for my stockholders, who are indirectly the savings and loans, to achieve the asset liability match that they are striving to achieve.

If the corporation were to compete, for example, in the construction loan field or in other markets that involve short term assets, I would be making it very difficult for those institutions to be viable.

I feel I have that responsibility. These are the stockholders that I serve. The board of directors that I serve also has an obligation to insure the viability of those institutions.

So one of the things that we've tried to do is avoid those markets where we would be in direct competition with the corporation's seller servicers, the commercial banks, and the savings and loans we serve. Since we do business as a pass-through vehicle we are not, in effect, competing for the same assets that the institutions we serve are trying to put in their portfolios.

Senator TOWER. Thank you. Incidentally, I might say that if any other panel members want to comment on these questions as a result of a direction of a question to a specific member of the panel, he's free to do so.

Mr. MAXWELL. Mr. Chairman, if I may, I would like to make one comment. I certainly agree with my colleague, Mr. Thygerson, on the proper role of secondary market institutions and particularly FNMA and FHLMC.

I would say that with respect to the broadened asset powers requested by FNMA that it should be clearly understood that these are real estate related and that the purpose of these is to enhance our assistance to the housing market, not to detract from it; and moreover, to make FNMA a more solid financial institution as a result.

Clearly, this would be a small part of our operations and would be related to residential real estate whether single family or multifamily in every case.

Frankly, I'm surprised that Mr. Thygerson hasn't mentioned the foremost advantage that FHLMC has over both FNMA and anyone in the private sector that might contemplate getting into the secondary market or issuing mortgage-backed securities, and that is the fact that their profits are not taxed—they are not subject to Federal income tax.

Senator TOWER. Let me ask both of you, Mr. Maxwell and Mr. Thygerson, just recently we've seen the rebirth of a private secondary mortgage market and there's some indications that other players might enter the field. This activity occurs mainly in higher valued mortgages that aren't currently served by FNMA or FHLMC.

If we raise or remove the limits on the mortgages you can purchase, won't we risk snuffing this private activity out because of the agency advantages that you have in the securities market?

Mr. THYGERSON. Mr. Chairman, on this issue we believe we are speaking on behalf of the housing market we are trying to serve. The homebuilders, real estate brokers, and lenders have encouraged us to move forward on this proposal. It would appear that the marketplace is facing a two-tier system. Mortage loans below the corporation's ceiling are easily traded in the secondary market, while these above the ceiling have limited access. This two-tier system, at least according to homebuilders, real estate people, and lenders we have talked to, is not being served in a uniform way.

The housing industry trade groups appearing here today know what's happening in the marketplace and may be able to provide additional information on this issue. They know what it means in terms of pricing. They know what it means in terms of ready availability of credit. It would appear that while many private initiatives are beginning they are not fully developed. I believe the market which is above our ceiling is growing, particularly in high cost areas. This market should be served and apparently is not being served properly at this juncture.

Mr. MAXWELL. I would agree with Mr. Thygerson. I think that there are three major points.

First of all, the market is uneven throughout the country with respect to the price of housing. For example, in Senator Trible's State several areas cannot be served by FHLMC and FNMA because of the $108,300 limit.

The second reason is that while these efforts are underway, it is a fact that other efforts in the past have had some difficulties. For instance, the Bank of America's issuance of mortgage-backed securities, which was in fact the first conventional mortgage-backed security issue, did not achieve liquidity because even the Bank of America's guarantee is not sufficient to satisfy investors as to the liquidity of that instrument. Another organization has recently come into being known as RFC. Nobody knows the extent of the acceptability of their guarantee except it's certain that it will not be as much as FHLMC and FNMA's guarantee.

The third reason is the question of price. We believe that inclusion of higher balance loans in mortgage-backed securities will be an advantage in the securities market and this can be passed on to American homeowners.

I reiterate, Mr. Chairman, it would be a very desirable step to change the system so that the guarantee of major competitors of FHLMC and FNMA can rise to their level, but we are not at that point at this time. In the meantime it would be to the advantage of the market and to American home buyers to raise these limits.

Senator TOWER. Mr. Gourley, do you have any comments on that?

Mr. GOURLEY. Yes, sir. The secondary market very badly needs a competitive climate that would come from the ability of FHLMC and FNMA to compete. Through the years we depended on thrift institutions and the life companies to furnish our money. As everybody is well aware, these two have not been secondary market providers of funds recently.

As prices have gone up, we have lost the ability to deal in higher loan amounts. We would have a place to sell these loans if both FNMA and the FHLMC entered the marketplace at a higher level. So far as we're concerned they could be unlimited, assuming that these two organizations can well underwrite their loans and know where to stop. We need them fully in the secondary market to maintain its overall competitive nature.

The other institutions that have come into the secondary marketplace, as David says, are new. They may be very successful, and we hope they are. We note that they have helped the competitive climate all over. Everyone is now looking at fees and charges. So we like it and think housing needs the competition very badly.

Senator TOWER. Mr. Hobgood or Mr. Dwire, do you have anything to add?

Mr. DWIRE. The ABA would certainly support an increase in the ceiling for the very reasons that have been expressed.

There's one additional thought that could be added to it, and that is that deposit institutions have learned the hard way that you cannot make long-term assets with short-term liabilities. For that purpose and in order to prevent the long-term fixed rate loan from totally disappearing, we think it's very important that FHLMC and FNMA remain in the secondary markets and that their authorities in terms of limits be increased.

Senator TOWER. Thank you. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Gentlemen, I'm sorry I wasn't able to be here for your presentation. Mr. Gourley, in your statement you stress, I think very properly, the appalling problem of the huge deficits we face, and the effect they are going to have on housing in particular.

Would you agree with me that the principal reason why housing suffered such a terrific, catastrophic drop in 1981 and 1982 was because of high interest rates?

Mr. GOURLEY. Yes, sir. We are very concerned and feel that getting the deficit under control is an absolute must.

Senator PROXMIRE. And you say the fact is that the budget does not make enough meaningful cuts in Federal spending, resulting in immense deficits in each of the next 5 fiscal years. Some people argue that if we recover, if we get unemployment down from the present level to 6 percent, that that might help solve the problem.

The fact is, however, that because of the tax cuts, because of the colossal increases in spending by 1988, the Congressional Budget Office projects that we will have over a $200 billion deficit even with a 6-percent unemployment rate and that would suggest to me that it's going to be extraordinarily difficult for us to have any kind of recovery in housing.

Is there anything the Federal Reserve Board can do under these circumstances to accommodate this kind of a situation? Supposing the Federal Reserve Board should provide some credit availability by simply buying half of the deficit. They can do that. They can buy it all for that matter. William McChesney Martin used to tell us when Wright Patman would ask him, "Why doesn't the Federal Reserve Board just buy up all of the Federal debt," he said, "Well, if you bought it up it wouldn't be worth anything when you got it." And I'm afraid that's the dilemma they're in; is it not?

Mr. GOURLEY. I would think so, but then I wish I was smart enough to respond to that.

Senator PROXMIRE. Is there anything the Fed can do under these circumstances to hold interest rates down in the face of this colossal deficit?

Mr. GOURLEY. I'm just a poor mortgage banker. So far as trying to be a——

Senator PROXMIRE. But you're a good mortgage banker; you may not be a good Chairman of the Fed.

Mr. GOURLEY. That job, I don't envy the gentleman at all and to try to suggest which direction he should take would be something I would think would be inappropriate for me, but getting the public confidence in what the future holds is an absolute must. The problem in long-term rates as we see it is the concern certainly for the future and what the deficits will mean, and until someone feels confident that the deficit is smaller they're going to have to keep that risk piece in the interest rates to provide for it.

Senator TOWER. I might suggest, Senator Proxmire, we might get Volcker up here to answer that question. I'd like to hear what he says.

Senator PROXMIRE. On housing, I think it would be very helpful.

Let me just ask you finally, Mr. Gourley, when it comes to putting on the lather you're a good barber. You can lather up the face. When it comes to shaving off the whiskers—in other words, the answer to what we do about this, how we get the deficit back in shape—you're a little general in your suggestions and gentle. But I can't blame you. But the chairman of this committee is also chairman of the Armed Services Committee and the outstanding——

Mr. GOURLEY. You're warning me not to answer your question.

Senator PROXMIRE. He's the outstanding expert on it and he's done a good job over the years, but you suggested we might take a good, hard look, at least at military spending, and find out if we can't in some way spend money a little later or hold it down. Can you be a little more specific than that?

Mr. GOURLEY. No.

Senator PROXMIRE. I don't blame you.

Mr. GOURLEY. It's fairly obvious from our economists and others, there are not a lot of other places to get it from, so defense is one place.

Senator PROXMIRE. Now if you talk about entitlement programs, there again I think you can make a strong case for cutting them, but cutting them is the hardest thing in the world, as you know. Cutting social security is the big one. We're in that thicket now and it's tough.

So, finally, to the extent that we cannot make the cuts that many would like to make, the one thing we can do is to postpone, for example, the third year of the tax cut. How do you feel about that?

Mr. GOURLEY. That's the last resort, but that is one certainly we would have to look at, but we want to look at the cuts in spending first.

Senator PROXMIRE. How about indexing? You see, in 1985 that would cost about $40 billion a year once it gets underway. That's the estimate on it.

Mr. GOURLEY. I think everything obviously would have to get a look at. As far as I'm concerned I'm not capable of speaking to them.

Senator PROXMIRE. At any rate, I take it from your five-page statement here you put most of your emphasis on the deficit and you think that if we're going to have a long-term future for housing we simply have to find a way, one way or the other, however tough and painful it is, to cut spending, increase revenues some way to get that deficit down; is that right?

Mr. GOURLEY. That's right. That's one of the reasons we made certain that we didn't look and ask for subsidies. We haven't over the last couple years said, "Come on, help housing by spending some money," because that adds to the deficit. So we tried to stay away from that.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Senator TOWER. Senator Hawkins.

Senator HAWKINS. I'll defer to Senator Trible.

Senator TOWER. Senator Trible.

Senator TRIBLE. Thank you, Mr. Chairman.

I have enjoyed the colloquy about the general state of the economy and I would simply say after that long discussion two things.

First of all, in my judgment, the huge deficits that we face are unacceptable but they are not a product of the taxes not being sufficiently high, but that we are spending too much money. And we've got to get serious about holding down spending. I don't think it's appropriate to talk about increasing taxes beyond the intolerable level of the present time.

Second, I'd point out, Mr. Gourley, that there are other places to look than national defense. It's my judgment we need to restrain the large defense increases projected by the administration, given our economic problems and the budgetary crisis that we face. But the truth is, that over the last decade or the decade of the 1970's to be more precise, defense spending was cut in half in real terms while nondefense spending increased dramatically. If we're really serious about holding down the deficit in the next fiscal year and beyond, we're going to have to take a hard look at the so-called entitlement programs and that's where substantial savings will be made and it's only in that area of government that substantial savings can be made.

Senator TOWER. If you're going to talk about defense spending I'm going to get down at that table.

Senator TRIBLE. Having made that brief soliloquy, let's try to generate colloquy here, gentlemen.

There's been some discussion in the administration about privatizing the operations of FNMA and FHLMC and I'd like to present this question to all the panel members that might wish to respond because there may be some divergent views on that.

What, in your judgment, would be the rationale for that proposal? What would it entail and how would it offset the operations of FHLMC and FNMA and perhaps more importantly the overall state of the economy?

Mr. THYGERSON. I go first?

Mr. MAXWELL. Always.

Mr. THYGERSON. Thank you. Capitalization of the corporation, which would have taken us to a more private mode, was an initiative that FHLMC brought before Congress last year. Privatization to the Corporation at that time meant basically three things. No. 1, what kind of powers would we have and in what areas would we have these powers? I believe that the proposal at that time would have maintained the thrust of FNMA's activity in real estate lending. I do not think there was anything in that proposal that would have diverted the corporations primary focus from the mortgage lending area. One aspect of privatization is the ability to be responsive to the marketplace. I think that Mr. Maxwell has indicated how important that is.

I would have to second that. It clearly is important. The market that we are facing today is moving so fast and so violently and in some cases, disruptively that it's very hard to keep up. Thus, broader powers make sense.

The second thing privatization means to us is access to capital. We do not have access to common stock beyond the initial capitalization of this Corporation in 1970. Our initial issue or $100 million of common stock is held by the 12 Federal Home Loan Banks. The only way we can currently finance our operation is through retained earnings which the Corporation has been able to build up over the years. We were very fortunate to gain the support of this committee last year to pass legislation authorizing the corporation to issue preferred stock. However, this is a limited market. In this market you are required to pay fairly sizable dividends in order to secure additional access to equity capital.

One aspect of privatization that makes a good deal of sense is the ability to move into the capital markets to attract the equity capital needed to leverage the growth of mortgage operations.

The final aspect of privatization deals with the level of control the stockholders and users have on the Corporation which determines how responsive you can be to market changes and needs. We have a Board of Directors, a very fine Board of Directors, made up of the three members of the Federal Home Loan Bank System under our congressional charter. But as you know, there is considerable turnover in that job. The Board's primary concern is running the Federal Home Loan Bank System and is, therefore limited in the amount of time which can be devoted to directing the activities of FHLMC. This has been a problem historically.

As part of the privatization discussion, we need to address issues such as expanding the board of directors to include outside board members which would provide greater continuity and direction for the Corporation. We are not at this juncture submitting any of these proposals before this committee, but I think these are the kinds of issues which may eventually need to be indorsed. We will be happy to work with the committee to try to resolve those issues.

Mr. MAXWELL. Well, Senator, the question of privatization as it has been put forward by the administration for the last 2 years is one that I have had the pleasure of discussing with them in some detail.

FNMA's position is unusual because it was part of the Federal Government and it was brought out entirely, I'm not sure that at the time it was really thought through exactly how FNMA was supposed to function. I think at that time, ironically, the effort was to get FNMA off the Federal budget because the outlays were too great, and to get social security onto the Federal budget so that the budget could have the benefit of the positive returns from social security.

In any event, FNMA is private. We are owned by more than 30,000 shareholders. We have 65 million shares outstanding. We receive no tax revenues. Our debt is not guaranteed. When we are fortunate enough to make some money, we pay taxes at the full corporate rate of 46 percent. We are private in every sense and I think probably the most dramatic way that I could say that—and I testified to the full committee to this effect a few weeks ago—is that we proved it in 1981 by very nearly going broke, and I don't believe that if you're part of the Government you can carry that off.

So, I think that the question of how much more private FNMA should be is one that we would like to address with this committee, as we have been doing with the administration. I believe that it would be a great mistake—and I think I have the facts and figures to prove it—to move FNMA farther away from its Government ties on the liability side of its balance sheet before we have more flexibility as to our assets. That's what happened with the savings and loans. Their liabilities were deregulated before their assets and although there were other problems in connection with their long-term lending and short-term borrowing, and that was one of the most serious problems they confronted.

We have approximately—and I've gotten used to approximating in billions since I've gotten to FNMA—we have approximately $40 billion of loans that yield 10 percent or less. Those loans are going to stay on our books and they are going to be a drag on our earnings into the foreseeable future. We had a strategy to meet that problem but without Federal subsidy. We haven't had any bailout or anything of that kind and without anything of that kind, it is going to take years, frankly, for us to work our way out of the position that FNMA got itself into prior to 1981.

I think that the other part of our strategy is legislative and that accounts for the proposals that we have put forward for the committee. I think that the market ought to be more private and I think that what we have to concentrate on is how we can change these institutions—FHLMC and FNMA and indeed possibly GNMA—to accommodate the entry of strong private entities because I've said, and I say again here today, that I don't think FHLMC and FNMA and GNMA can serve the whole needs of the secondary market in housing in the 1980's. That is precisely what we would like to work with you and the other members of the committee to move forward.

Senator TRIBLE. Thank you, sir. If I still have time, are there other members that wish to tackle that question?

Mr. HOBGOOD. Senator, I would say in the role that I represent, which would be an investor in some of these products, I'm not sure that the privatization is the key issue because I think, as was just stated, the market is very large and could be served by a number of institutions. I think that there is a need in the private sector to come out with a vehicle—maybe the administration's proposal on TIMS with certain modifications is one of the solutions I think the ability to raise funds and make them attractive for the investor is the key issue because in the role of a pension fund manager or foundation manager or whatever you may be you need to have instruments that are well accepted in the marketplace and trade-like instruments that you're used to seeing, and I think this is something we've not appropriately addressed and one that we are hopeful as the administration works through TIM's will be, in order that this type of market—the mortgage market, is served in the same way as any of our corporate bonds would be. This is something I would be very supportive of, but I'm not sure just the privatization of these Government entities would answer the question.

Mr. GOURLEY. Senator, one thing I might add, to the extent broader powers are needed and privatization would give broader power, it would help the functioning of the secondary market and to that extent we certainly would support it.

Senator TRIBLE. Well, I thank you. I just got a little note saying, "Senator, your time has expired," so, Mr. Chairman, I thank you and I thank Mrs. Hawkins for permitting me to go ahead of my distinguished senior colleague from Florida.

Senator HAWKINS. That doesn't happen often.

My principal concern and one that my constituents continue to write about is that we really need a further reduction in interest rates and there's an article in yesterday's Wall Street Journal that caught my eye and states that current mortgage rates are still high by historical standards making median price new homes affordable to only about one-third of the American households.

That's a very small number to be able to own a home in the future, and I'd like to ask any member of the panel why, in your opinion, have mortgage interest rates failed to decline as fast as the rate of inflation has declined?

Mr. GOURLEY. Fear of the future. Investors' fear of what the future holds. Deficits that are so large that investors don't really know how much of the money will be available. We do know that the Government uses a tremendous amount of it over the next several years based on the deficit and it scares investors to death and rightfully so.

Senator HAWKINS. Therefore, what's the future of the traditional 30-year mortgage?

Mr. GOURLEY. Well, there are still markets out there. Fortunately, there are still some investors who can invest in 30-year loans. They can match liabilities or they have the assets power that would let them do this. So they have the matching liabilities. But again, that's like the long-term bond markets in general. There's still a market there. There are certain people who would invest long term because there are still some people and always will be, who think that rates might be as low now as they're going to be 10 years from now, so they invest to get the current yield at long term.

Senator HAWKINS. Are any of your customers resisting the new short-term mortgage instruments?

Mr. GOURLEY. You used the word "any"—no question about it. Lots of them resist the short-term adjustable rate mortgages. It depends on local markets. We certainly have got a lot of people accustomed to them and they are now much more acceptable than they were because I think they're a fact of life and we have sold it in that fashion. We'll have a combination of the two; we'll have variable rate mortgages because they are necessary if we're going to have the funds in housing. So we hope to have fixed rate mortgages as well as the variable rate or adjustable rate mortgages. As people become accustomed to them, they become much more acceptable; but if they have the option between fixed rate and adjustable—fixed.

Senator HAWKINS. Does anybody care to predict the future course of home mortgage interest rates since we're crystal-balling here?

Mr. MAXWELL. Where angels fear to tread. We at FNMA believe that mortgage interest rates cannot come down too much below what they are now. We believe that there will be a two-tier market and I think the way that consumers will be attracted to the shorter term mortgages is because the rates will be considerably lower on them. For example, at the present time, FNMA's rate for purchasing a 30-year fixed rate mortgage is 12.95, but you can get from FNMA a 5-year adjustable rate mortgage for under 10 percent with a buy-down feature in the mortgage, and that is proving attractive, I think to a number of consumers.

The problem with the overall level of mortgage rates coming down is that mortgage rates are now tied to the capital market. Because of the deregulation of depository institutions, the subsidy that used to be built into those rates is no longer there. They are now going to reflect rate levels in the long-term bond market to the extent that they're 30-year mortgages, and as Mr. Gourley said, people in the long-term bond market have been terribly, terribly scared by what's occurred in the last 10 years and they are insisting on a rate premium in order to put their money into longer term instruments. I don't expect that that's going to change.

Senator HAWKINS. Thank you. That's all I have, Mr. Chairman.

Senator TOWER. Getting back to Senator Hawkins' question on interest rates, why interest rates didn't come down in the face of increasing projections of Federal budget deficits? Was that because of inflationary expectations have ameliorated somewhat?

Mr. THYGERSON. Senator, I think that clearly with the inflation rates having come down now below 5 percent that it's had a very salutary effect on credit markets and I think recently the situation in the Middle East with respect to oil prices has had a very material effect on the market's expectation of continued lower inflation.

Nevertheless, Senator Hawkins was correct. Long-term interest rates remain very high, and I think that with the prospect, as Senator Proxmire indicated, of these looming deficits, it is going to be very hard to see single digit long-term interest rates in the balance of 1983.

Senator TOWER. Well, I want to thank the panel.

Senator PROXMIRE. May I just ask one question, Mr. Chairman?

Senator TOWER. Fire away, Senator Proxmire.

Senator PROXMIRE. Mr. Maxwell, you said something about FNMA not having had any subsidy or any bailout. Didn't FNMA obtain a bailout last year in the sense of tax legislation to provide additional loss carrybacks and carryforwards?

Mr. MAXWELL. No, sir. The tax situation with FNMA when it became a private corporation was that it was given the same 3-year carryback and 15-year carryforward as a manufacturing company and the problem with that was that it was not the same as other financial institutions such as banks and thrift institutions.

The Congress, with the sponsorship of Chairman Rostenkowski of the Ways and Means Committee, and in the Senate under the leadership of the Senate Finance Committee, corrected that inequity. That will result in——

Senator PROXMIRE. That correction was not simply for FNMA then; it was for all institutions?

Mr. MAXWELL. Well, they already had a 5-year carryforward and a 10-year carryback for the thrift institutions and for the banks.

Senator PROXMIRE. What you're saying is you were put in the same position as these others?

Mr. MAXWELL. That's right, and that did not affect the fundamental problem that we have with the imbalance of our assets.

Senator PROXMIRE. What taxes did FNMA pay in 1981, 1982, and what do you expect to pay in 1983?

Mr. MAXWELL. Well, we didn't pay any taxes in 1981 because we lost $190 million and we paid no taxes in 1982 because we lost $105 million. In 1983, I'd be very happy to pay some taxes and maybe we will. I hope so. I can't predict to you precisely.

Senator PROXMIRE. You don't have a sufficient carryforward from your losses so that you can be assured you won't pay taxes in 1983 either?

Mr. MAXWELL. No. There is no carryforward. If we have earnings, we will pay taxes in 1983.

Senator PROXMIRE. You will?

Mr. MAXWELL. Yes, sir.

Senator PROXMIRE. Thank you.

Senator TOWER. I want to thank the members of the panel very much, Mr. Thygerson, Mr. Maxwell, Mr. Hobgood, Mr. Dwire, and Mr. Gourley. Thank you for very useful testimony.

If the panelists would take their seats, please. Our second panel today is a panel on assisted housing and we have with us Mr. John Koelemij, Mr. Tom White, Cushing Dolbeare, and Ms. Florence Roisman. We are delighted to have you here. We ask each of you to present your testimony. If you have lengthy statements we would be grateful to you if you would insert those in the record where they will appear in their entirety and summarize them for the committee so that we can give over enough time for questions. Let me yield to Senator Hawkins. I believe she has a remark to make.

Senator HAWKINS. It gives me great pleasure to mention that one of the members on this panel represents Florida and is a very distinguished Floridian from Tallahassee. Mr. Koelemij is an American success story, being a Dutch immigrant, and has been responsible for more than 3,000 residential units being built in Florida during the last 28 years. As people know throughout the country, Florida is still building. We're still growing at a rapid rate and this industry alone contributes over $10 billion to the economy in Florida. The homebuilders are to be commended for having made over 100,000 starts last year in Florida. So I'm interested in the comments of all of the witnesses here today but want to give a special welcome to my colleague from Florida.

Senator TOWER. I might add, I have never seen a Dutch immigrant on the relief rolls in this country. They always do well.

Mr. KOELEMIJ. Thank you, sir.

Senator TOWER. Well, we'll start off with you today, Mr. Koelemij, and then we'll hear from the other panelists in turn.

STATEMENT OF JOHN J. KOELEMIJ, VICE PRESIDENT, TREASURER, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. KOELEMIJ. Thank you, Senator, and thank you, Mrs. Hawkins, for your nice remarks.

[Complete statement follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF HOME BUILDERS [NAHB]

Mr. Chairman and Members of the Subcommittee: My name is John Koelemij and I am a homebuilder from Tallahassee, Florida. I am testifying on behalf of the more than 105,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry of which I am Vice President-Treasurer. Accompanying me today are Robert D. Bannister, Senior Staff Vice President for Government Affairs and Jim Schuyler, Staff Vice President and Legislative Counsel. I am pleased to be here to testify on FY '84 authorization legislation for housing programs.

Mr. Chairman, let me begin by welcoming you back as the "first chair" of the Housing Subcommittee in your new role as Chairman of this vital Subcommittee. We at NAHB know how important the health of the housing industry in your home state is to the national housing industry. Our Economics Department estimates that in 1982 over one-fifth of the private housing production in the nation occurred in Texas (240,000 starts). You are well aware, Mr. Chairman, of the importance of housing production to the Texas economy and, indeed, to the overall national economy.

Turning to the truly parochial, I am very pleased that my own Senator Paula Hawkins has joined this Subcommittee. We're not ready to compete with Texas—yet. However, housing production in Florida last year was estimated at 100,000, the second most active state in the nation, with almost one-tenth of all housing starts nationwide. We Floridians, through our experience with the rollercoaster of highs and lows in housing production during the last decade, can assure you that our state economy certainly prefers the "highs."

With these two relatively bright spots on the housing scene, we must recognize that other regions of the country have suffered disproportionately during this housing recession. For example, Texas produced more housing than the entire West or the North Central area, and double the production level of the Northeast in 1982.

I will not detail the status of the housing industry today, since our President, Harry Pryde, testified before the full Committee on February 14 on those issues.

But I would like to offer a few observations. Housing data in the last few months has generated great optimism. No one could have predicted a rebound of such dimensions even six months ago. Housing starts, sales and building permits were all unusually strong in January. It seems likely that these record increases from month to month cannot be sustained. NAHB is still projecting housing production levels of 1.39 million in 1983, a 30 percent increase over 1982—not 1.7 million starts, the seasonally adjusted annual rate for January. The acid test of the strength of the recovery will come during the peak spring production months—when seasonal factors have a deflationary influence on housing statistics. Many builders have started homes over the past three months with the expectation of a recovery in the spring. After up to three years of inactivity, this should not be too surprising. Inventory of new homes has steadily dropped during the recession. Building up of inventory is one way of making sure that there will be houses to sell when the azaleas begin to bloom. Demand for housing is clearly stronger than it was one year ago due to declining interest rates. But mortgage interest rates remain very high by historical standards. And income to qualify for a mortgage remains the major obstacle for many potential homebuyers. As this Committee knows, the general economic recession is still not over. To conclude, Mr. Chairman, we fully expect housing statistics in the next few months which will show much less than the dramatic improvements of the last three months. And as we have been warning for the last few months, if interest rates trend upward, or if the Federal Reserve Board changes course as Chairman Volcker suggested earlier this week, or if federal deficits continue to $200 billion range for the next three to five years . . . all bets are off.

HOUSING PRODUCTION PROGRAMS

I. Multifamily

Regarding multifamily production, we appeared before the Subcommittee last year to urge that the "pipeline" of HUD projects be moved as quickly as possible. We maintained that the pipeline was the only source of production that could have an impact on starts, employment and the economy in 1982. We are grateful to this Committee, and in particular Chairman Garn and Senator Riegle, for your support in that regard. There are still some problems in this area but we hope they can be dealt with on an administrative level.

But "you never miss the water till the well runs dry." We have indicated to this Subcommittee on a number of occasions that there is a rental housing crisis. It is true that the extent of the crisis differs from area to area and from market to market. There are at least two crises: renters are being squeezed beyond their means, and the rental inventory is being squeezed for units. The construction of rental apartments aready lags substantially behind the need. Uriel Mannheim, a respected housing economist, projects the demand for new multifamily rental units at 350,000 per year during this decade. The construction level for 1981 and 1982 was between 175,000 and 200,000 units, short by 150,000 to 175,000 units per year. And about one-third of the units each year were built under the Section 8 program, now targeted for extinction.

We generally support the approach taken by Senator Dodd and Representative Schumer for a new multifamily rental production program. Such a program, if funded at a reasonable level, would begin to expand the supply of rental housing in areas experiencing severe shortages. There are a number of principles which we believe should be embodied in a final legislative package.

First, we believe that such a program should provide direct access by developers to project funding. We are concerned that the local role provided for in Dodd/Schumer will discourage sufficient private developer participation in the program. In addition, some communities which have a demonstrated need for housing may choose not to apply for funding due to their inability to manage a complex local housing program. We are pleased that the program does provide for the option of state agency administration of the program, based upon their demonstrated capacity in this area. One option which might be considered is to provide a HUD discretionary fund with direct application by developers under circumstances where the local government decides not to apply for funding.

Second, we believe that eligible uses of the funds should be broadened to include a variety of different mortgage instruments and programs, including the Administration-proposed graduated payment mortgage, 15-year balloon mortgage, second mortgages, 15-year "put" and co-insurance combined with tax-exempt financing. All of these options would help to reduce the market rate of the mortgage loan and thus reduce the amount of assistance needed under the Dodd/Schumer program to make a project financially feasible.

Third, we would urge that moderate rehabilitation not be included in a rental production program. The purpose of the program is "to increase the housing stock" and the program is based upon applications for specific projects. We feel that moderate rehabilitation is more appropriately dealt with as part of an overall local neighborhood program either under the Administration block-grant proposal or some other assistance mechanism.

There are a number of other recommendations we would make in this area regarding rent/income ratios, applicability of Davis-Bacon, project selection criteria and terms of assistance. We will be pleased to submit our views to the Subcommittee and your professional staff for your review.

II. Single Family

Mr. Chairman, without debating the likely impact of the so-called Lugar emergency interest reduction program if it were activated in 1982, we are not seeking a similar stimulus program for fiscal year 1984. I fervently hope that we are on the path to a lasting housing recovery by this spring and that interest rates will be on the decline so that we will not have to seek activation of such a program later this year.

However, there is one segment of the population which cannot be served by the private sector without government assistance. I refer to homebuyers who have benefitted from the revised Section 235 program. We cannot project that market interest rates will ever be low enough to allow us to serve families of 95 percent of area median income or below.

A number of our builders have successfully used the Section 235 program and fought for the recapture provisions and other recent refinements which have improved the effectiveness of the program. We would urge you to consider extension of this program at a modest level of funding to continue a federal commitment to homeownership for lower income families. Because of our concern with the long-term budget authority impact of 235, we would recommend that assistance be provided for a maximum of ten years (rather than 30 years) for eligible homeowners. This would substantially reduce the federal long-term obligation as computed in the budget. In fact, it is our understanding that most homeowners no longer receive assistance after seven years as their incomes rise sufficiently to meet their entire monthly payments. Therefore, we believe that a limitation on assistance to 10 years would not be a hardship for homebuyers under the program. As a safeguard, we would suggest that the funds recaptured upon sale of a home under the program be available as supplementary assistance for these families who continue to be eligible and in need of assistance beyond the 10 year term.

FHA UNSUBSIDIZED PROGRAMS

Mr. Chairman, we cannot compete with our friend Willard Gourley of the Mortgage Bankers Association in his comprehensive analysis of FHA programs in the Administration bill. We would be pleased to provide our detailed recommendations in the near future. Let me discuss the highlights. I will not belabor the issue of the importance of the FHA insurance, VA-guarantee and GNMA mortgage-backed security programs. Since the creation of FHA in 1934, more than 16 million homes have been purchased with low downpayment mortgages insured by the federal government at no cost to the public. Obviously, this is the worst time to restrict government insurance for housing as the recovery is underway. The reports of the death of the fixed-rate mortgage are greatly exaggerated. FHA and VA represent the major source of low-downpayment, fixed-rate long-term mortgages available today and throughout the housing cycle. GNMA is essential to provide the capital necessary to finance these loans. We should certainly not turn away from the proven GNMA program in today's environment, while we continue to work for an acceptable conventional mortgage-backed security program. Therefore, we would oppose setting any commitment limits which would restrict the use of these programs. In addition, we would oppose any Administration proposal to restrict FHA activity to first-time homebuyers or inner-city residents. Such proposals are not in the interest of maintaining the actuarially sound and successful FHA program that we will continue to need in the future. In that light, we would oppose the Administration's proposed changes in the FHA downpayment rules because they are of minimal benefit to any homebuyer and would penalize home purchasers of modest homes in high-cost areas. This proposal is just another attempt by OMB to restrict and eventually dismantle FHA—only this time it is couched in terms of benefitting the "low-income."

Regarding multifamily housing, we strongly support the provision in the Administration's bill which extends HUD authority to insure graduated payment mortgages for multifamily projects. We are in the process of analyzing the impact of this proposal in detail based upon a variety of GPM plans and interest-rate assumptions. Our preliminary view is that the GPM provides a major new alternative for financing private rental production. When used in conjunction with Dodd/Schumer, the GPM provides a very attractive package which would reduce the cost of federal assistance.

However, we believe that the Administration's proposal to disallow tax-free treatment for co-insurance loans financed with tax-free obligations goes in the opposite direction. At a time when the multifamily co-insurance program has just begun, the ability to use a major financing mechanism (tax-exempt bonds) would be terminated. The co-insurance program with tax-exempt financing provides a real option to make private rental production feasible.

To provide other options which would stimulate multifamily production, we would support amendment of Section 207 of the National Housing Act to authorize 15-year "balloon" mortgages; amendment to Section 212(g)(4) to allow optional assignment by mortgagee to HUD after 15 years; and amendment of Section 207 to allow a "soft" second mortgage not payable until year 15.

Mr. Chairman, as we have expressed in the past, we remain concerned about statutory and proposed regulatory changes in income limits for eligibility under the Section 8 program. We fear that restricting this housing to families with incomes below 50 percent of median area income will seriously threaten the economic viability of many financially sound projects.

In an effort to stabilize many HUD-insured, troubled projects, HUD encouraged a socio-economic mix among the resident population. This was designed to overcome the high default and foreclosure rate that resulted in many projects where the tenant population was composed of very low-income occupants. These statutory and regulatory changes will certainly pose a threat to the HUD-assisted project insurance program. It appears we have not learned from the past and are attempting to recreate the unacceptable project instability situation that existed in the early and mid-1970's.

We urge you to reconsider these income limit changes in order to protect the financial soundness of these programs and to avoid increasing the federal contribution for rent and operating assistance.

SECONDARY MORTGAGE MARKET

A strong secondary mortgage market is essential to the nation's system of residential mortgage finance. The difficulty of matching long-term loans with short-term deposits is forcing lenders to sell more of their loans on the secondary market. At the present time, more than one-half of the one-to-four family home mortgages originated are sold on the secondary market. As the leading secondary market institutions for conventional home mortgages, the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) provide liquidity for mortgage originators and attract new investment in housing.

Their excellent service to the nation has been threatened in many markets by rising housing prices. FNMA and FHLMC can purchase mortgage loans up to a maximum based on the Federal Home Loan Bank Board's (FHLBB) index of nationwide average home purchase prices. Mortgage limits for single family homes are currently $108,300. That maximum mortgage limit was below the price of the average single family home in 19 SMSAs in 1982, according to the FHLBB. I want to emphasize that these are average prices and not the high end of the housing market.

Mortgage originators in those SMSAs face greater difficulties in reselling mortgages above the FNMA/FHLMC limits on the secondary market. Thus, homebuyers must pay a premium to obtain the loans. That premium is added on to the home cost, which makes it even harder to obtain affordable housing. For FNMA and FHLMC to continue to serve the entire nation, the maximum mortgage purchase limits should be removed, as in S. 2067 the late-lamented fiscal year 1983 housing bill. We urge you to authorize FNMA and FHLMC to set mortgage purchase limits on the basis of prevailing national and local market conditions. We are confident that this change will not diminish the support that FNMA and FHLMC currently extend to moderately-priced housing. Removal of the purchase limits would remove an unnecessary barrier to home finance and would help stimulate the housing recovery.

We are concerned about other amendments which have been proposed by FNMA and FHLMC. Since we have no official policy on these issues, our Executive Committee will be considering our policy position at our meeting on March 15. We will be pleased to convey our views at that time.

Other statutory and regulatory barriers need to be eliminated for the secondary mortgage market to make use of one of the most promising vehicles available to attract investment into housing. Conventional mortgage-backed securities (CMBS) currently face obstacles that are the result of past policy decisions made before such securities were contemplated. The President's Commission on Housing recommended the elimination of legal, tax and regulatory obstacles to the development of broad markets for CMBS.

The Administration has developed the concept of Trusts for Investments in Mortgages (TIMs) to overcome the obstacles and to make CMBS viable in the capital markets. Conventional mortgage-backed securities designated as TIMs would be relieved from the legal and regulatory barriers to their use. The Administration has already obtained some regulatory changes. The Securities and Exchange Commission agreed to allow simplified shelf registration of CMBS issues. Under the simplified procedure, an issuer must give notice to the SEC but need not obtain approval prior to the sale of an issue.

These and other regulatory changes open the way for CMBS, but that path will only be clear if legislation is enacted to make changes in the tax code to accommodate this new instrument. The Administration is considering such a proposal and we urge you to work with the Finance Committee to gain favorable consideration when presented.

CONCLUSION

Mr. Chairman, in our testimony before this Committee on February 14, I believe that we made a very strong case that from fiscal year 1980 to fiscal year 1984, the federal commitment to housing programs has been virtually wiped out. At the same time, we have moved further away from the elusive goal of a balanced budget. Maybe there is a lesson to be learned here. We have long maintained that a consistent and responsible federal role in housing production is money well spent . . . it produces decent housing, creates jobs and benefits the economy. We ask you to bear that in mind as you review direct federal expenditures for housing this year.

As always, we stand ready to assist this Subcommittee and your highly competent staff as you continue the housing authorization process. I would be pleased to answer any questions you may have.

Senator TOWER. Thank you, Mr. Koelemij.
Mr. White.

STATEMENT OF TOM WHITE, EXECUTIVE VICE PRESIDENT, COUNCIL OF STATE HOUSING AGENCIES

Mr. WHITE. Thank you, Mr. Chairman.
[Complete statement follows:]

STATEMENT OF THOMAS W. WHITE, EXECUTIVE VICE PRESIDENT, COUNCIL OF STATE HOUSING AGENCIES

Mr. Chairman and members of the Housing and Community Development Subcommittee, thank you very much for the opportunity to testify today. My name is Tom White and I am executive vice president of the Council of State Housing Agencies. The Council of State Housing Agencies represents the State-authorized housing finance agencies in 48 States, and the finance agencies in the city of New York, the District of Columbia, the Virgin Islands, and the Commonwealth of Puerto Rico. Mr. Chairman, I would ask that my written comments be published as part of the record. I will summarize my comments here today.

First, Mr. Chairman, I would like to comment on the housing environment in which you act this year.

Housing is on the rebound in general, however, the recovery is a fragile one. Many market analysts consider a rebound in interest rates a definite possibility for later this year. Even if mortgage interest rates remain at twelve percent, an income of over $30,000 will be required to purchase a modestly priced home.

The situation for rental housing is becoming critical. Total conventional multifamily rental starts in 1982 were slightly over 130,000 nationwide. The economics of supply and demand preclude the private sector from filling the giant gap left by the elimination of Federal rental housing production programs without some form of governmental assistance.

A HOUSING POLICY PERSPECTIVE

CSHA is vitally concerned with preserving the overall housing stock of America, and with the housing of low and moderate income families, the elderly, and the handicapped. State agency charters direct the agencies to help private industry help those who cannot be served by private resources without governmental assistance. The agencies link private and public housing efforts in a meaningful partnership.

State agencies have always been interested in low income housing. Together such agencies financed 30 percent of the section 8 programs. This year, States will pass 900,000 units of housing financed for low and moderate income Americans. This includes both homeownership and rental units.

Regarding this year's housing legislation, we recommend the following for committee consideration:

1. Funding for housing

This year the administration has proposed only $515 million in new dollars for housing. This is a 94 percent reduction from fiscal year 1983. The total budget authority recommended of $4.1 billion is based on the recapture or reuse of funds previously allocated. We are of the opinion that there will not be sufficient recaptures to allow the administration to fund its proposal, and we believe the level of overall funding to be inadequate.

What is fair for housing in relationship to the entire budget is not an issue that the council is qualified to address, nor were we organized to so do. However, we must point out that the funds in the HUD budget do not seem adequate in relationship to need.

2. Preserving presently assisted housing

Congress must preserve presently assisted low income housing as a first priority. This is actually a very inexpensive way to provide affordable housing for millions of Americans. Thus, within reason, we consider the need for public housing operating and modernization funds to be a priority, although we do not operate such projects.

Although the State agency portfolio itself is basically sound (indeed it must be or the agencies could not continue to finance housing as we are regulated by the bond market) we also have need for the funding of operational section 236 projects. Current low income contracts providing for deep subsidy units in section 236 projects must be provided amendment funds if these units are to remain low income. The flexible subsidy program for section 236 projects should also be continued for State uninsured projects as well as for insured projects. The HUD proposal for the 1984 budget ignores the congressional direction of last year to fund these programs. We urge you this year to include statutory language to solve this problem once and for all. Attached is a detailed description of the issue. We will be submitting specific statutory language to the staff today for committee consideration.

3. A balanced program is essential

CSHA has always argued that the Nation is best served with a variety of programs allowing for adaptation to local needs. We again support this thesis.

We would urge that the committee continue public housing funding, the 202 program, and for targeted purposes such as 202, the section 8 program.

This year we will not be proposing section 8 production subsidies other than 202, but Congress should not lose sight of the fact that while expensive, the section 8 program had many advantages as a deep subsidy program. It may be, particularly for some types of elderly housing, a vehicle that Congress will want to revisit at a later date.

We also support the section 8 existing housing program. We are in process of reviewing HUD's proposal to convert these programs to what they call the housing payment certificate programs. We have several problems with this suggestion, and we have attached a brief description of our analyses thus far. We will continue to comment as we receive additional information from the many States who are now reviewing the proposal.

Last, but not least, we urge this committee to adopt a new production program component within their overall strategy.

4. An intergovernmental housing fund

Last year, the Senate approved a targeted housing grant fund for State and local government. We supported in our testimony many of the provisions adopted by the committee.

Over the last year I have participated in housing community discussions on what we would recommend for an assisted housing program to replace the section 8 rehabilitation and new construction program.

These discussions started with the Senate and House housing committees commitment to flexible State and local role in designing and administering the program funds. I am pleased to say that many good proposals evolved. I am particularly pleased to be associated with a discussion proposal developed in conjunction with the housing offices of the League of Cities and the Conference of Mayors which is attached to this testimony. We have also closely worked with the National Association of Housing and Redevelopment Officials on shared elements in their and our proposals.

Our joint proposal would meld many of the characteristics of the Senate and House proposals of last year. As noted, it is a discussion proposal. It is not set in concrete, nor is it formally approved by the participating parties, although it has been reviewed by appropriate committees of the conference, the league, and the council.

The joint proposal has a 3 part funding system which recognizes the value of State financed and administered housing production over the past decade, as well as providing the bulk of the funds for entitlement cities.

As noted earlier in this testimony, State housing finance agencies have provided for 30 percent of all section 8 financing, and in the first years of section 8, we provided the leadership to make the program workable. State agencies can do it again if given the chance.

Also the joint proposal is flexible in giving HUD a major role which should meet some of the criticism in the development community of a proliferation of local programs. The HUD role would allow the development of a standard national program as well as State and local options.

What is most important is for this committee is to move forward quickly to the floor and then to conference. Our proposal can be studied and debated in detail before the conference to see if it has merit as a program. In the meanwhile, we support the passage of the essential components developed by the committee in last year's legislation.

5. *Rural housing*

Last year and this year the possibility of a State block grant replacing the Farmers Home Administration assisted housing programs has been proposed. Let me make clear that this proposal was not suggested or supported by us. However, we at the council do have an interest in rural housing. Many State agencies spend most of their effort in rural America, and others, even in so called "urban" States have substantial rural programs. We are meeting with rural organizations and among our members to see if we can make some suggestions to you which will help rural housing without being devisive. To this end we also support a rural housing budget for 1984 equal to that now in place.

6. *Tax-exempt financing*

Prior to commenting on CSHA's No. 1 priority this year, the elimination of the December 31, 1983 sunset or mortgage revenue bond financing, let me comment on the HUD proposal to eliminate tax exempt financing for co-insured projects. Such financing is permitted under tax law and no one to our knowledge on the tax committee is proposing otherwise. It seems strange to us that tax exempt financing would be continued under this proposal to be available to fully insured projects but not to projects which involve private or public risk. Or is this a foot in the door? We hope not. Without tax exempt financing most of the rental housing production we will see in the next few years will simply not be built.

Finally we must comment on the CSHA No. 1 priority for this year—the elimination of the sunset on December 31, 1983 of the mortgage revenue bond authorization. The list of supporters committed to elimination of the sunset grows daily. A partial list of supporters includes:

National Governors' Association;
National Conference of State Legislatures;
United States Conference of Mayors;
National Association of Housing and Redevelopment Officials;
Council of State Community Affairs Agencies;
Association of Local Housing Finance Agencies;
American Institute of Architects;
National Association of Home Builders;
National Association of Realtors;
National Lumber and Building Materials Dealers Association;
Public Securities Association;
National Association of Counties;
Northeastern Retail Lumbermens Association.

As of yesterday, we had 44 Senate cosponsors for S. 137, the Roth-Mitchell bill eliminating the sunset. We urge any of you not on the bill to join up now.

In conclusion, we need a housing bill this year. We support your efforts, Mr. Chairman, to move quickly as evidenced by these hearings. Last year we testified on April 15. We thank you for your consideration of our comments.

Attachment 1

Rent Supplement and Rental Assistance Payments

Section 101 of the Housing and Urban Development Act of 1965 and Section 236 of the National Housing Act make specific provisions for assistance to low income tenants under the Rent Supplement Program and the Rental Assistance Payments (RAP) program. These subsidies are provided in amounts equal to an approved rental charge of 30% of the tenants monthly income.

Periodically, contracts which have been executed under the Rent Supplement and Rental Assistance Payments programs have been amended to reflect increases in maximum monthly rents or decreases in qualified tenants incomes. Until now, these amendments have been executed without regard as to whether the housing covered by such contracts have been subject to a mortgage insured under the National Housing Act.

The Council of State Housing Agencies is now aware and vehemently opposes efforts on the part of HUD to terminate the funding of necessary amendments to existing Rent Supplement and Rental Assistance Payments contracts financed by State Housing Finance Agencies without FHA insurance. The Department's proposed action creates an artificial distinction between projects which were insured by FHA and those which were not and will place projects financed by bond proceeds at risk. Further, the Department's inequitable distinction between insured and non-insured projects will ultimately force qualified tenants to vacate units where necessary rent increases occasioned by increased operating and maintenance costs are required.

The Department's intention to terminate the funding of amendments in light of the Secretary's obligation found in the statutes for both programs, and, in light of the expressed intent of the Congress reflected in the last December's continuing resolution, is noted in the Department's 1984 budget which acts to rescind rent supplement and rental assistance payment subsidies which should be utilized to provide needed amendments. This must not be allowed to occur if indeed state agencies are to be able to continue to preserve the existing stock of low income housing and avoid placing approximately 30,000 state financed units assisted under Rent Supplement and RAP at risk.

Attachment 2

Section 8 Housing Payment Certificate Program

CSHA's initial analysis of the Department's Housing Payment Certificate program finds the while several adjustments have been made by the Department which may serve to improve the effectiveness of the program, a number of key issues remain and will require a more detailed analysis which CSHA will provide under separate cover. Highlighted below are our outstanding questions with respect to the implementation of this program.

- The so-called "shopper's incentive" which allows a family to rent below the payment standard for a given area places a tremendous burden of responsibility on the administering agent for the program who must ensure that housing quality standards are adhered to. A potential conflict may exist where families are encouraged to pocket excess subisdies and administering agents are required to maintain housing quality standards. Significant administrative delays may be caused where families are encouraged to find units which rent for less than the payment standards and PHAs are required to enforce Housing Quality Standards. Units selected by tenants seeking to achieve cash savings may not meet Housing Quality Standards thus forcing the family to relocate and PHAs to reinspect more than one unit for that family.

- Stipulating that no additional funds will be provided for adjustments increasing the amount of assistance payments under this program, sets a dangerous and unrealistic precondition where certain and necessary rent increases may be needed to support operating and maintenance cost increases. Owners will be forced to raise rents which will ultimately displace tenants receiving a level of assistance under this program that will enable no longer be sufficient to enable them to to afford to live in the unit. Allowing PHA's to restrict the total number of households served over the life of the program in order to retain available amounts sufficient to cover such adjustments virtually assures that fewer persons will be served.

- It is not clear what is intended in the Department's statement that the Housing Payment Certificate program would be limited to a term of five year or less.

- Owners may be unduly affected by the provision in the legislation for vacancy payments which states that "payments for vacant units would be limited to the remainder of the month during which the tenant leaves the unit" where that tenant leaves shortly before the end of the month and there is not time to find another tenant to fill the vacant unit. In this regard no provision has been made for a security deposit. This particular aspect of the legislation will act to discourage owner participation.

- The legislation does not clearly state whether or not PHAs have the option to make payment to either the owner or the tenant. Sound administration of the program would be maintained where funds are provided to the owner.

- The legislation does not detail how the Annual Contributions Contract will be determined and on what basis it will be determined in a particular area.

- The legislation also does not identify how the adminstering agency would cover expenses incurred in the implementation of the program.

- It is unclear in reading the legislation whether or not tenants currently assisted under the Section 8 Existing housing program would be required to pay 30% of income upon conversion to the Housing Payment Certificate Program.

Attachment 3

March 11, 1983

A Proposal for an Intergovernmental Housing Fund

A discussion proposal prepared by the housing offices of The League of Cities, the Conference of Mayors and the Council of State Housing Agencies.

Purpose of Proposal

- Present a joint intergovernmental proposal.
- Address current legislative issues.
- Offer a program that can obtain wide support in the housing community.

Concepts

- It's time to replace the rehabilitation and new construction elements of Section 8 that were eliminated.
- It's time for a state/local governmental block grant for housing to utilize decentralized skills and to meet local housing needs.
- The program should stress private-public partnerships which have been proven to be effective in assisted housing.
- Gross duplication of governmental effort should be avoided, but competitive governmental delivery systems have proven to be effective over the past decade.
- Alternative federal, local, and state delivery systems allow for balance and redress within the program.
- Although decentralization is critical to the proposal, a strong federal option is provided.
- Program support systems (e.g. FHA insurance, tax exempt financing) are continued.

Program Linkages

Directly linked to this program would be a Section 8 Existing Housing or voucher system and the continued availability of tax exempt financing.

Also, to fully implement a national program, this proposal envisions a linkage to other federally sponsored programs which would be continued.

Public Housing
202 Housing
Section 8 Housing for special purposes such as 202
Adequately funded rural housing programs (e.g. Farm Home, etc.)

Purpose of the Proposed Housing Program

- Provide funds directly to local and state governments to encourage the construction or rehabilitation of housing units, primarily for occupancy by low- and moderate-income persons.
- Encourage private participation by providing program direction for private ownership of multifamily rental housing.
- Provide funds for state government to have a statewide program if organized to accomplish program objectives.
- Allow for a control program to be administered by the federal government (HUD).

Funding Level

The proposal contemplates at least $1 billion in initial funding.

Eligible Applicants

Total funding in the program initially would be split in 4 ways:

1. 10% to states for state agencies capable of financing and administering state wide programs;

OF THE REMAINING 90%

2. 20% of the remainder for state government efforts related to non-metro areas not being served by Farmers Home Administration (small non-metro cities); and
3. 70% of the remaining 80% for distribution to metro area entitlement communities; and
4. 30% of the 80% to HUD for discretionary administration for metro area communities.

State Funding for Statewide Program

Funds would be allocated to States for use in all areas of the state. State agencies would have to apply for the funds, including certifications of legal ability to undertake development and financing of multifamily rehabilitation and/or new construction, capacity to operate such programs, and a needs analysis and plan for administering the funds. 80% of the funds would be made available on a formula basis among qualified states and 20% of the funds could be allocated at the secretary's discretion to recognize outstanding performance.

State Program for Non-Metro Small Cities

Allocated to States for use in non-metro areas not being adequately served by Farmers Home Administration programs. Funds would be made available to states on a formula basis, using criteria similar to the current "Fair Share" distribution system. States would be required to submit applications similar to those required of entitlement jurisdictions and may allocate the funds competitively to local governments or administer programs on their behalf. Consultation would be required. If the state agency fails to administer the funds, HUD will assume responsibility.

Funding for Entitlement Communities

Funds would be made available on an entitlement basis to local governments meeting certain criteria:

- entitlement status under CDBG; and
- certain other criteria designed to target assistance to localities based on relative levels of distress and condition of rental housing.

A total of 70 percent of the funds set aside for local governments would be distributed by entitlement.

Funding for HUD Discretionary Use

Thirty percent of the metro funds would be distributed on a discretionary basis by HUD. Eligible applicants for this 30 percent "basket" would include units of local government, public development agencies, or developers. All applications would have to include a certification signed by the chief elected official of the unit of local government in which the project would be located approving the application. Financing could be provided by state finance agencies.

Eligible Activities

Grants may be used to finance the new construction or rehabilitation of rental housing units in any way deemed suitable by the recipient jurisdiction. In the case of HUD's discretionary program, the Secretary will administer a competitive grant program.

At least 75 percent of the funds made available to any recipient under this Act must be used to foster the development of housing units which will be occupied and available to low- and moderate-income persons and affordable at rents not exceeding 30 percent of those persons' income*. The remaining 25 percent may be used for purposes not specifically attributable to low- and moderate-income housing. In order to facilitate the use of these funds to benefit low- and moderate-income persons, grantees will be allocated Section 8 Existing Housing Certificates which can be used for units assisted under this program.

All of the funds must be used to either create new housing units, put a vacant unit back into the housing stock, or prevent a unit from being removed from active use in the housing stock.

Grant Administration

Grants to states and localities would be 100 percent federal. No administrative costs will be allowed out of the federal grant funds. Localities and states may use other funds, such as CDBG, GRS, local revenues, housing or financing fees to finance the administration of the program. Entitlement governmental units would be required to submit an annual application for funds, which would include an assessment of local housing needs, establishment of priorities in alleviating this need, with primary emphasis on the needs of low and moderate income persons, and a plan for using the entitlement funds. Administering agencies would certify compliance with applicable civil rights citizen participation and other relevant federal requirements. All applications, submission and proposals to HUD shall be publicly available. The HUD Secretary could withhold funding from entitlement or state grantees on a finding that the application was clearly inappropriate to the housing needs of the community, that the grantee's prior performance in administering the program failed to demonstrate adequate capacity to carry out the program, or that the grantee was in violation of any of the certifications submitted in an application.

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*Efforts are being made to research this proposal to see if 50% is a better balance between production and low income than 75%.

Local communities could designate an agency to administer the program such as the Public Housing Agency.

In the event that an entitlement community is denied funds, or fails to apply for funds to which it is entitled, the Secretary shall reallocate these funds to a regional or state agency which agrees to administer the program in the locality; and finally, HUD shall administer the program on behalf of the community.

Funds shall be awarded on an annual basis, drawn down through a letter of credit when needed. Funds which have been awarded to local governments but not obligated within 24 months of award shall be recaptured by HUD for reallocation in the program, without prejudice to the applicant's subsequent applications. Such reallocation shall be first to other jurisdictions in the same metropolitan area, than within the same state, and finally back to HUD for national distribution if none of these applications chooses to use the funds.

States will be required to file annual applications similar to those required of entitlement jurisdictions. States will be required to certify that they have undertaken a consultation with the jurisdictions under their authority in the program on both the allocation and the general purposes for which the state funds will be available. Such consultation will take place prior to filing of the application, and the application shall certify that such consultations have been completed. All plans, proposals, and applications submitted to HUD by the state shall be public information and made freely available within the state.

State housing finance agencies shall qualify for entitlement upon filing an annual application certifying their capacity to undertake a program consistent with the purposes of the statute, their legal authority to undertake such a program, a program for using the entitlement funds, and a certification that the agency's program has been developed in coordination with other state and local housing plans.

Federal Administration

The program would be administered by the Secretary of HUD. The program would be authorized for not less than 3 years, with annual appropriations. The HUD Secretary would be required to publish regulations governing the program within 180 days of enactment. The Secretary would have to disapprove any entitlement applications within 45 days of receipt or the entitlement funds would be distributed to the applicants.

The HUD Secretary will administer the discretionary program in metropolitan areas in a manner consistent with the goals and purposes of the statute. The Secretary may undertake innovative projects, develop new approaches, or encourage innovative project development with these funds. The primary purpose of the discretionary program, however, is to stimulate maximum production and rehabilitation of housing units, principally for occupancy at an affordable rent by low- and moderate-income persons.

Mr. WHITE. Mr. Chairman, we have a little button here that we prepared for the mortgage revenue bond campaign that says "Don't let the sun set on the American dream?" We prepared it for our homeownership effort here, but I think it's equally applicable to the assisted housing programs that people of low income also desire and need decent, sanitary, safe housing, a secure environment, and we support the efforts of this committee to do what you can to make sure that their dream is not lost also. We think you're doing so by moving quickly, by the way. Last year we testified on April 15; today is March 11. You've already got a good headstart under your leadership and we think that under your leadership we will continue to see progress and we thank you for the opportunity to present this testimony.

Senator TOWER. Thank you very much for an excellent contribution, Mr. White. Actually, my leadership is not really responsible for the advance in the timing scheduled. We had agreed to advance the agenda this year in an effort to give us more time to spend with our constituents. In fact, we passed our legislative schedule before the debate on the budget and we hope for an early report on the budget resolution and hopeful we can get all of our authorizing and appropriating legislation done by the end of the fiscal year. I wish I had great confidence that we could do it. I'm not sure that I do, but we're going to try, but we will address ourselves to the markup on this bill in a timely fashion.

Mrs. Dolbeare.

STATEMENT OF CUSHING DOLBEARE, PRESIDENT, LOW INCOME HOUSING COALITION

Mrs. DOLBEARE. Thank you, Mr. Chairman.

I, too, want to express my appreciation for the opportunity to testify this morning and also my pleasure that you will be chairing a most important subcommittee. We look forward to working with you and to continuing to work with the very able staff of the subcommittee on both sides of the aisle.

Senator TOWER. Actually, I'm sort of a retread. At one time I was the ranking minority member on this subcommittee. Now I have been recycled and I'm back in the chairmanship role for at least this Congress. We don't know what will happen in the next one.

Mrs. DOLBEARE. And, of course, at one time the honorary chairman of the coalition is former Senator Edward Brooke, who was also the ranking minority member of this subcommittee.

Senator TOWER. That's right.

Mrs. DOLBEARE. I would like to request not only that my testimony be printed in full in the record but, if possible, a special memorandum summarizing the housing budget with a good deal of tabular information that compares the HUD and Farmers Home budget proposal back to 1980 also be included in the record and be considered a part of my statement.

Senator TOWER. That will be done.

Mrs. DOLBEARE. The National Low Income Housing Coalition is a membership organization composed of individuals and organizations concerned about the housing plight of low-income people. Our membership base is very broad. In addition to tenant groups, neighborhood groups, churches, civil rights groups, and so forth, it includes the National Association of Homebuilders and the Council of State Housing Agencies. I think that's an indication that there is a broad constituency of concern for low-income people.

I would disagree slightly with Tom White, who's a member of our board. I think the Sun has set on the American dream for low-income people when it comes to housing.

It seems to me that the way to approach housing assistance needs and housing assistance programs is first to attempt to examine the nature of the problem and the dimensions of the problem; then to ask ourselves what should be done about the problem in order to solve it; and then to step back, necessarily, and ask how much of that can we do this year and what should we be doing this year. That's the general framework of my testimony.

The 1970's were a decade in which housing conditions improved for most Americans but not for low-income people. We're a nation of homeowners in this country. The homeownership rate in this country is 65 percent. But fewer than half of all households with incomes below $10,000 are able to own their own homes. The rest rent. And the rental housing gap, the affordability gap, is becoming increasingly critical.

In 1970, there were 2.5 million more units that rented for $75 or less than there were households with incomes of $3,000 and $75 per month is 30 percent of a $3,000 income. We don't think people at that income level can afford 30 percent of their income for housing. But there was housing in the stock in 1970. By 1980, there were 300,000 more households with incomes below $3,000 a year than there were housing units of any size, shape, variety, availability, condition, and so forth, in the entire housing stock that rented for less than $75 a month.

If you go up to the next step in the income level, households with incomes below $5,000 a year, there was in 1980—and it's gotten worse since—a gap of close to a million units. That is, there were a million more families at that very low income level than there were units in the entire housing inventory—again regardless of quality, location, or availability—which they could afford at 30 percent of their income.

During the decade of the 1970's, renter income in constant dollars, rose by 22 percent and median rents rose by 63 percent. That was more than the increase in housing costs in constant dollars for homeowners whether they had mortgages or whether they did not.

In 1970, there were 5.8 million renter households with incomes below $3,000. In 1970, the median rent paid by those households was a little less than $75 a month and the household at the top of that income bracket, with an income of $3,000, would be paying 34 percent of their income for rent and would have $165 left for all their other uses.

In 1980, there were far fewer, fortunately, households with incomes below $3,000, but there were still almost 3 million; 2.7 million renter households in this country with household income below $3,000. These are official HUD-Census Bureau figures. The median rent paid by those households had risen from $85 a month to $179 a month, which is 72 percent of an income of $3,000, which meant a family paying median rent with income at the top of the range would have only $71 a month left to meet all of its other needs.

Now half of those 2 million families were single persons. The other half were families of two or more. About 5 percent were families of five or more. That's the affordability problem which we need to address ourselves to.

We have had in this country subsidized housing programs for close to half a century. In that half a century, we will have provided, when all of the units that are now in the pipeline for HUD and The Farmers Home Administration programs are built and occupied, somewhat more than 5 million units. That's a million units a decade. We are not keeping up with the need.

The budget request submitted by President Reagan for additional budget authority for low income housing, which is the critical number when it comes to how much each year we are going to add to the number of families or the number of buildings that we are providing housing assistance for, is a 98 percent cut from the budget level which President Ford submitted in the budget that he proposed just before he left office. In constant dollars, it is 1.2 percent of that budget request. It's 1.5 percent in constant dollars of the budget request submitted by former President Carter just before he left office. In the Carter years, in constant dollars, the amount that was proposed for low-income housing assistance dropped slightly.

That's the context in which you're asked to legislate on low-income housing programs.

EIGHT MAJOR ITEMS

The National Low-Income Housing Coalition suggests that in order to meet the problem, the full dimensions of the problem, there are eight major things which we need to do.

First, we need to adopt an adequately funded entitlement, income-based housing assistance program to enable low-income people to obtain decent housing at costs they can afford. That's a long mouthful for saying what some people call vouchers, but if we're going to use vouchers, there are three conditions, none of which the administration's proposals meet, by the way.

First, the program should be universal. We should define who is eligible and then we should provide vouchers for every household that is eligible. That proposal is not a new one. It was made most recently, however, not by us but by the American Heritage Foundation.

Second, the voucher amount should be enough to cover the difference between whatever we decide is the amount that low-income people can afford and should be asked to pay and the cost of housing that they actually are able to obtain. The administration's proposal for modifying fair market rents to lower the payment standard falls short of that.

Finally, if we don't want costs to escalate out of sight, we need to couple vouchers with a supply-side approach to provide additional new and rehabilitated housing designed for occupancy by low-income people.

The remaining points of the National Low-Income Housing Coalition's program addresses additional things which need to be done on top of an entitlement program—production and preservation of low-income housing, strengthen fair housing laws and their enforcement, a strong role for community-based, nonprofit organizations through the implementation of low-income housing programs, retention in viable condition of the current stock of federally assisted and insured low-income housing, no displacement of low-income people from their neighborhoods by either public or private action. We aren't even providing enough additional units and haven't been for the last several years to provide assistance for the low-income people who are being displaced, let alone the people who already have problems. Tax reform to curb the massive subsidies which we are providing through the tax system, and I just received this morning from my friends at HUD a copy of the 1982 housing production report and there's a table in the appendix that shows in 1982 mortgage interest and property tax deductions cost the Federal Government over $30 billion, and only $2 billion of that amount benefitted people with incomes below $20,000.

Finally, monetary and credit policy to provide reasonable financing costs and get us off of this up and down building cycle which add unnecessarily to housing cost.

Specific on recommendations on pending legislation and authorizations. First, we recommend authorization of budget authority for low income housing assistance at the level of $30 billion, which is the level that was approved by the Congress with bipartisan support, as I recall it, for 1981. That's the 15- or 20-year runout cost. The annual cost would be less than $2 billion once all the units are built and online, and that would happen in approximately 1988.

I would love to be able to come here and talk about ways of cutting the budget or ways of providing low-income housing which would not involve a major Federal financial commitment. There is nothing I would rather do, because I know the problems of providing adequately for financial support with the deficit problem. But the simple fact is that, when you are trying to provide assistance for people who cannot pay more than $75 or $100 or $125 a month for shelter, there is no way to do it without substantial expenditures.

We do not expect to provide education without spending money for schools. We do not expect to provide health care without spending money for doctors and hospitals and, similarly, we cannot provide low-income housing without spending money for housing assistance. Yet we have never spent even one percent, in outlays, of the Federal budget on providing housing assistance for low-income people; and even if Congress were to approve the $30 billion that we request we still would not be reaching the 1 percent level in Federal outlays for low-income housing.

Second, I urge you to reject again the proposal of the administration that food stamps be counted as income in determining eligibility in rent for low-income housing.

Some 42 percent of assisted housing tenants receive food stamps and depend on food stamps and, even though they get food stamps, they have incomes that with their food stamps place them below the poverty level. And the effect of this proposal, if it were to be adopted, would be to increase the rents of those people by 27 percent of the value of their food stamps. There's a table in my prepared statement on the impact of that for a mother on AFDC with three children State by State.

In the State of Texas, that change would increase the rent paid by that family by 473 percent, and it would mean, after the rent increase was phased in, that that family would have exactly $1.73 per day to live on for the mother and her three children after paying her rent. There is no way that I can imagine that a family of four can live on $1.73 a day after paying their rent. I urge you again to reject that proposal.

We cannot deal with our housing problems without continued construction and rehabilitation housing units earmarked and subsidized for low-income people. I urge you again to include in this year's authorization bill major approaches which you had last year, the approaches which were designed to prevent the disposition of public housing projects without adequate replacement housing, to provide protections under the modified section 8 existing program (if you choose to modify it) to see that the payment standard is in fact adequate, and to provide an opportunity for additional housing production.

There are some other specific recommendations in my prepared statement. In the interest of time I will omit them. I will simply point out that at the rate the administration proposes to provide vouchers it will take 150 years to provide vouchers for the families that the President's Commission on Housing, which has the lowest response estimate that I know of of housing needs, says are essential and at the rate at which the administration proposes to provide rehabilitation funds through its rehabilitation block grant—there's a slight improvement—we could rehabilitate the buildings which Secretary Pierce said in his prepared backup material were seriously substandard in 147 years. That is not I think a program which can be described as a serious attempt to deal with a major and desperate national housing problem. Thank you.

Senator TOWER. Thank you, Mrs. Dolbeare, for your very eloquent testimony.

[The complete statement follows:]

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Hon. Edward W. Brooke, *Chairperson*
Cushing N. Dolbeare, *President*

LOW INCOME HOUSING NEEDS AND PROGRAMS: A WIDENING GAP

Statement of Cushing N. Dolbeare, President, National Low Income Housing Coalition, before Housing Subcommittee, Senate Committee on Banking, Finance, and Urban Affairs, March 10, 1983.

This testimony will attempt to put the legislative proposals before the Subcommittee in the context of low income housing needs and the diminishing federal program response to them. It will then deal with a number of the specific proposals made by the Administration and others.

THE CONTEXT: LOW INCOME HOUSING NEEDS

The decade of the 1970's was one of rapid housing change. Among other things, it saw, with the completion of almost one million units authorized by the Housing Act of 1968 and an additional 1.2 million units under the Section 8 program, a substantial increase in the subsidized housing inventory. Even so, while housing progress was marked for most people, low income people fell further and further behind.

Between 1970 and 1980, according to the Annual Housing Survey, the number of occupied housing units increased by 27%. Home ownership continued to rise, though more slowly than during the 1950's and 1960's. In 1980, 65.6% of all households owned their homes, compared to 62.9% in 1970. The number of units lacking some or all plumbing facilities -- a traditional measure of housing quality -- dropped by 46%. Nevertheless, there were still 2.4 million units lacking plumbing.

Tenure continued to be closely related to income. In 1980, more than half of all households with incomes below $10,000 rented. In contrast, only 29% of those with higher incomes rented.

Housing costs have risen far more rapidly than incomes. In 1970, median renter income was $6300 and median rent was $108. By 1980, median renter income had risen to $10500, a 67% increase, but median rent was $241 per month, a 123% increase. Converted to constant dollars, we estimate the change in income and rents or housing costs as follows:

Chart I. Significant changes, 1970-1980, in housing affordability for renters
(Numbers in thousands)

1970		
HH under $3000	5769	***********************************
Units under $75	8208	**
1980		
HH under $3000	2748	*****************
Units under $75	2458	***************
1970		
HH $3000-4999	3565	**********************
Units: $75-124	6700	***
1980		
HH $3000-4999	3598	**********************
Units: $75-124	2987	******************
1970		
HH $5000-6999	3661	**********************
Units $125-174	3967	************************
1980		
HH $5000-6999	2882	******************
Units $125-$174	4575	****************************
		CUMULATIVE
1970		
HH under $5000	9334	*****************
Units under $125	14908	***************************
1980		
HH under $5000	6346	************
Units under $125	5445	**********
1970		
HH under $7000	12995	************************
Units under $175	18875	**********************************
1980		
HH under $7000	9228	*****************
Units under $175	10020	******************
1970		
Total renter HH	23560	***
White	19601	************************************
Black	3607	*******
Married couples	17171	*******************************
Other male HHr	1143	**
Other female HHr	3270	******
Single persons	6389	************
1980		
Total renter HH	27556	**
White	21894	**
Black	4827	*********
Married couples	17772	********************************
Other male HHr	2238	****
Other female HHr	5716	**********
Single persons	9784	******************

Source: Low Income Housing Information Service (based on data from 1980 Annual Housing Survey)

Income and housing costs, 1970 and 1980, in 1972 constant dollars

	1970	1980	Change	
Median renter income	$6810	$8316	$1506	22.1%
Median rent	117	191	74	63.2%
Median owner income	$10486	$15682	$5196	49.6%
Median value	$18486	$40630	$22144	119.8%
Median monthly cost				
Unmortgaged	65	104	39	60.0%
Mortgaged	186	291	105	56.5%

Moreover, the greatest problems were at the bottom of the income scale. It is almost impossible to convey the intensity and magnitude of the housing problems of our very lowest income renters. The charts on the following pages are an effort to do so. Chart 1 shows the changes in housing affordability for renters between 1970 and 1980. In 1970, there were 5.7 million households with incomes under $3,000 and another 2.7 million households with incomes between $3,000 and $5,000. At the same time, there were 8.2 million units renting for less than $75 per month (30% of $3,000) and another 6.7 million units at rents between $75 and $125 per month. In other words, there were 5.6 million more units renting for less than $125 per month than there were renter households with incomes below $5,000. Even so, the situation was far from satisfactory: many of the units in this low rent range were seriously substandard; or they were the wrong size; or they were in the wrong locations; or the owners discriminated against would-be tenants; or, finally, they were occupied at bargain rents by higher income households.

By 1980, the situation was infinitely worse, and although hard data is not yet available, we have every reason to believe that the past two years have been even grimmer. In 1980 there were still 2.7 million renter households with incomes below $3000, but the number of units renting for less than $75 had dropped to 2.4 million. There were also 0.6 million more renter household with incomes between $3000 and $5000 than units at rents between $75-125.

This is reflected in the very high rent-income ratios paid by households with incomes below $5000: almost all of them pay more than half their incomes for shelter. In contrast, as Chart II shows, almost none of the households with incomes above $20,000 pay as much as one quarter of their income for rent, including utilities.

> In 1970, a family with an income of $3,000 (the top of the range) at the median rent of $85 paid by the 5.8 million renter households with incomes below $3000 would spend 34% of its income for shelter, leaving $165 for all other needs.
>
> In 1980, the family with an income of $3,000 at the median rent of $179 paid by the 2.7 million households with incomes below $3,000 would spend 72% of its income for shelter and have only $71 for all other needs.

Moreover, only 19% of the renter households in this lowest income bracket lived in subsidized housing in 1980. More than half, 51%, were households of two or more people; 5% were households of five or more; 49% were single person households. More than one quarter, 27%, were female-headed households; 13%

Table 1. Significant changes in the housing inventory, 1970-80

	1980	1970	1970-80 Change Number	 Percent
All housing units	88207	68672	19535	28.4
Vacant/seasonal	2183	973	1210	124.4
Year-round units	86204	67699	18505	27.3
Owner-occupied	52516	39886	12630	31.7
White	48028	37005	11023	29.8
Black	3776	2568	1208	47.0
Renter-occupied	27556	23560	3996	17.0
White	21894	19601	2293	11.7
Black	4827	3607	1220	33.8
Vacant	5953	4254	1699	39.9
Lacking plumbing	2359	4398	-2039	-46.4
Owner-occupied	765	1662	-897	-54.0
Renter-occupied	988	1849	-861	-46.6
Median no of rooms	5.1	5.0	0.1	2.0
Owner-occupied	5.8	5.6	0.2	3.6
Renter-occupied	4.0	4.0	0	0
Median no of persons				
Owner-occupied	2.6	3.0	-0.4	-13.3
Renter-occupied	2.0	2.3	-0.3	-13.0
Married couples, no nonrelatives	55281	47977	7304	15.2
Owner-occupied	37509	30806	6703	21.8
Renter-occupied	17772	17171	601	3.5
Other male householder	4264	2441	1823	74.7
Owner-occupied	2026	1298	728	56.1
Renter-occupied	2238	1143	1095	95.8
Other female householder	10743	6289	4454	70.8
Owner-occupied	5027	3019	2008	66.5
Renter-occupied	5716	3270	2446	74.8
1-person households	17738	11151	6587	59.1
Owner-occupied	7954	4762	3192	67.0
Renter-occupied	9784	6389	3395	53.1
Median Income				
Owners	19800	9700	10100	104.1
Renters	10500	6300	4200	66.7
Median value, owner-occupied	51300	17100	34200	200.0
Median rent, renter-occupied	241	108	133	123.1
Renter income				
Under $3000	2748	5769	-3021	-52.4
$3000-4999	3598	3565	33	0.9
$5000-5999	1445	1847	-402	-21.8
$6000-6999	1437	1814	-377	-20.8
$7000-9999	3863	4620	-757	-16.4
Rental units				
Under $80	2622	8755	-6133	-70.1
$80-99	1114	3332	-2218	-66.6
$100-149	3676	5641	-1965	-34.8
$150-199	5103	2293	2810	122.5
$200-299	8307	806	7501	930.6

Source: Low Income Housing Information Service (based on data in Annual Housing Survey: 1980, Part A, General Housing Characteristics.

CHART II.

RENT-INCOME RATIOS, BY INCOME, U.S., 1980.

```
Income under $3000
  Under 25%            135000  *
  25-34%               210000  **
  35-49%               231000  **
  Over 50%            2172000  **********************

Income $3000-6999
  Under 25%           1086000  ***********
  25-34%               956000  **********
  35-49%              1541000  ****************
  Over 50%            2895000  ******************************

Income $7000-9999
  Under 25%           1008000  **********
  25-34%              1248000  *************
  35-49%              1146000  ************
  Over 50%             457000  *****

Income $10000-14999
  Under 25%           2742000  ****************************
  25-34%              1894000  *******************
  35-49%               738000  ********
  Over 50%             180000  **

Income $15000-19999
  Under 25%           2829000  *****************************
  25-34%               691000  *******
  35-49%               131000  *
  Over 50%              20000

Income $20000 or more
  Under 25%           4889000  **************************************************
  25-34%               316000  ***
  35-49%                30000
  Over 50%               6000
```

Source: Compiled by Low Income Housing Information Service from 1980 Annual Housing Survey Data.

were married couples with no other nonrelatives in the household; 6% were male-headed households. There were children under 18 in 27% of the households, with 6% having three or more children. Only 4% paid less than 25% of income for rent; 59% paid 60% or more. Ten percent lived in units lacking some or all plumbing facilities; 4% were overcrowded. Twenty-nine percent were black; 8% were of Hispanic origin. All had incomes below 75% of the poverty level. Forty-six percent lived in central cities; 31% lived outside of metropolitan areas.

These households are the poorest of the poor, but in 1980 they were less than one third of all households with incomes below the poverty level. There were also another 3.3 million renter households with incomes above $3,000, but below the poverty level, and another 4.9 million owner-occupants below the poverty level.

In other words, when we speak of low income housing needs, we are, by the most conservative estimates, talking about millions of people: 29 million in all, including more than 11 million children (4 million of them under six) and 4 million elderly people.

President Reagan's Commission on Housing, in its report last year, used a less conservative estimate of housing need: households with incomes below 50% of median. There are 20 million such households, half of them renters. Only one quarter of these renter households are now in subsidized housing. In other words, for each family now in low income housing — after close to half a century of providing housing assistance — there are three others who need it, who probably want it, and who can't get it.

The achievements of our housing assistance efforts over the last half century sharply contrast with this picture of housing need. At the end of fiscal 1984, if all goes as planned, HUD will be providing housing assistance to not quite four million households and the Farmers Home Administration will be assisting another million.

A rough picture of the characteristics of households living in much assisted housing is provided by a recent Census Bureau report. The report covers only rental housing, omitting the owner-occupied units assisted under HUD's Section 235 and FmHA's 502 programs. Thus, the total picked up by this survey is well below the actual number of units subsidized. It includes occupied units assisted through public housing, Section 8 and other rental subsidy programs. About 11% of all renter households received federal housing assistance in 1981. But, significantly, almost one third of all female-headed households with incomes below the poverty level lived in assisted housing, as did almost 37% of elderly households. Some 43% of assisted housing tenants also received food stamps, and four fifths of these households were below the poverty level. (See Table 2.)

Table 3 shows some of the characteristics of low income housing residents. Three fifths were white. Three fifths were family households, but more than half of these were headed by women with no husband present. There were children in just under half of all households. Half of all assisted housing was in central cities; another quarter was outside metropolitan areas. (See Table 3 for additional details).

Table 2. Total households, renter households, and households in subsidized housing

Housing Characteristic	All households			Renter households			Renter households in Subsidized housing		
	Total	Below poverty level		Total	Below poverty level		Total	Below poverty level	
		Number	%		Number	%		Number	%
All households	83527	11676	14.0	27210	6371	23.4	2873	1510	52.6
Female householder, no husband present	9403	3252	34.6	4645	2283	49.1	1044	706	67.6
Householder 65 or over	17312	3185	18.4	4076	1183	29.0	949	433	45.6
NONCASH BENEFITS									
Food stamps	7115	5600	78.7	4639	3816	82.3	171	119	69.6
School lunches	5356	3334	62.2	3053	2181	71.4	141	35	24.8
Medicaid coverage	8487	5561	65.5	4483	3569	79.6	261	120	46.0
Food stamps/school lunch/sub hsg	--	--	--	--	--	--	113	83	73.5
Food stamps/Medicaid/sub hsg	--	--	--	--	--	--	490	430	87.8
School lunch/Medicaid/sub hsg	--	--	--	--	--	--	53	30	56.6
All four	--	--	--	--	--	--	471	397	84.3
Total, hsg + food stamps							1245	1029	82.7

Source: Characteristics of Households and Persons Receiving Selected Noncash Benefits, 1981.

Table 3. Selected characteristics of households in subsidized housing, 1981 (numbers in thousands)

Characteristic	Total		Median	Below 100% of poverty			Below 125% of poverty	
	Number	Percent	Income	Number	Rate	Percent	Number	Rate
All households	2873	100.0	6055	1510	52.6	100.0	1931	67.2
White	1710	59.5	5959	804	47.0	53.2	1090	63.7
Black	1070	37.2	6081	659	61.6	43.6	781	73.0
Hispanic	229	8.0	6821	145	63.3	9.6	169	73.8
Family households	1724	60.0	7826	921	53.4	61.0	1103	64.0
Married-couple families	634	22.1	10838	195	30.8	12.9	272	42.9
Female householder, no husband present	1044	36.3	6033	706	67.6	46.8	811	77.7
Male householder, no wife present	46	1.6	—	21	45.7	1.4	21	45.7
Nonfamily households	1149	40.0	4573	589	51.3	39.0	828	72.1
Male householder	244	8.5	4869	113	46.3	7.5	160	65.6
Female householder	905	31.5	4511	476	52.6	31.5	667	73.7
Households with children under 18 years old	1397	48.6	7512	840	60.1	55.6	991	70.9
With children under 6	774	26.9	7524	496	64.1	32.8	571	73.8
Householder 65 or over	949	33.0	4863	433	45.6	28.7	648	68.3
Size of household								
Single person	1104	38.4	4530	564	51.1	37.4	796	72.1
2 persons	575	20.0	7056	246	42.8	16.3	301	52.3
3 persons	455	15.8	6624	251	55.2	16.6	304	66.8
4 persons	370	12.9	8668	204	55.1	13.5	253	68.4
5 persons	196	6.8	9381	125	63.8	8.3	139	70.9
6 persons	93	3.2	9621	56	60.2	3.7	68	73.1
7 persons or more	81	2.8	10565	64	79.0	4.2	70	86.4
Residence								
Inside metro areas	2157	75.1	6050	1139	52.8	75.4	1460	67.7
In central cities	1473	51.3	5764	841	57.1	55.7	1044	70.9
Outside central citie	684	23.8	6656	299	43.7	19.8	416	60.8
Outside metro areas	716	24.9	6071	371	51.8	24.6	471	65.8
Worked at fulltime jobs	804	28.0	10715	255	31.8	16.9	352	18.2
Worked at parttime jobs	315	11.0	6789	155	49.2	10.3	196	62.2
Did not work	1695	59.0	4568	1097	64.7	72.6	1371	80.9

Source: Characteristics of Households and Persons Receiving Selected Noncash Benefits, 1981

FUNDAMENTAL ELEMENTS OF AN ADEQUATE LOW INCOME HOUSING PROGRAM

The National Low Income Housing Coalition is now embarked on a process of developing specific proposals for a housing program that will, in fact, provided decent, affordable housing for all. We urge that the Congress reaffirm this national goal and enact legislation and appropriations that make significant progress toward meeting it.

An adequate low income housing program would, we believe, incorporate the following elements:

- An adequately funded entitlement, income-based housing assistance program to enable low income people to obtain decent housing at costs they can afford.
- Production and preservation programs to meet those low income housing needs which cannot be met by income-support programs alone.
- Strengthened fair housing laws and enforcement and a strong reaffirmation of the federal government's role in guaranteeing fair access to housing.
- A strong role for community based, nonprofit organizations in the implementation of housing programs, along with the availability of federal assistance to meet the broad range of housing needs at the neighborhood and community level.
- Retention of the current stock of federally assisted and insured housing now occupied by low and moderate income people for their use and provision of the necessary funds to maintain it in viable condition. (This includes all present public housing, HUD-assisted, HUD-insured and HUD-held units, as well as units assisted by the Farmers Home Administration.)
- No displacement of low income people from their neighborhoods by either public or private action.
- Tax reform to curb massive housing subsidies through the tax system to middle and upper income people, particularly as long as budget constraints inhibit adequate housing aid to low income people. The cost of housing-related tax subsidies has risen from $26 billion in 1980 to an estimated $43 billion in 1984. At the same time, new budget authority for low income housing is set, under the Administration's proposals, to drop from $26 billion in 1980 to $0.5 billion in 1984.
- Monetary and credit policies to provide reasonable financing costs for housing and limit credit-related sharp fluctuations in building which increase the costs, prices, and rents of all housing.

We believe that these elements provide the framework for a viable approach to meeting this nation's housing needs and we urge that they be used by this committee as a test for its actions this year: that you take no action which moves us away from these objectives.

SPECIFIC RECOMMENDATIONS ON PENDING LEGISLATION

For most of the last half century, housing has not been a partisan issue. Low income housing programs have had the support of both Republicans and Democrats. Moreover, there is a broad and growing constituency of concerned individuals and organizations that support expanded federal assistance to meet low income housing needs.

Yet, since 1980, low income housing programs have been cut savagely. The budget request for additional low income housing assistance for 1984 is, in constant dollars, only 1.2% of the level proposed by President Gerald Ford just before he left office. It is one-sixtieth of the amount actually appropriated for fiscal 1981, before the cuts, cancellations and rescissions began.

WE RECOMMEND AUTHORIZATION OF AT LEAST $30 BILLION IN BUDGET AUTHORITY FOR ADDITIONAL LOW INCOME HOUSING ASSISTANCE.

This would bring us back to the 1981 level. Depending on the approach used, it would require somewhere between $1.5 and $1.8 billion in contract authority: the limit on maximum annual expenditures. Moreover, it is about half of the estimated 1983-84 growth in homeowner deductions for mortgage interest and property taxes which provide an increasingly costly housing subsidy for middle and upper income people.

There is, unfortunately, no way of providing adequate housing assistance for low income people without spending or commiting money for it. Just as we do not expect to be able to provide education, or health care, or highways without significant costs, we should recognize that an adequate low income housing program will require increased spending. We can and should find more efficient program approaches, but we cannot provide decent housing with mirrors or by reshuffling past appropriations.

> The Administration's proposed changes in the Section 8 Existing program, they believe, would provide vouchers to 67,000 households in 1983 for $642 million instead of $3.8 billion in budget authority. Why not, instead of attempting to defer the funds to finance 40% of the 1984 program, use it to assist an additional 297,000 households? Doing it their way, the 1983 appropriation would provide a total of 364,000 certificates, without the deferral. (This would, of course, require an increase in contract authority and higher outlays for the next five years.) Even without the hidden rent increase which is built into the Administration's approach by setting an unrealistically low payment standard, at least 225,000 more households could be assisted with the budget authority provided for 1983 if the Administration had been willing to ask for the additional contract authority to do it.

Moreover, the cuts of the past three years have not yet really begun to be felt, as our chart demonstrates. While reservations for construction or rehabilitation of assisted housing have been steadily dropping, completions (and therefore occupancies) are still going up: the result of the decision made by Congress last year that the pipeline should be built, not cancelled.

The Administration has made much of addressing the problem of housing affordability. But it does not do so. Even the 90,000 additional units

CHART III.

RESERVATIONS, STARTS, AND OCCUPANCIES (COMPLETIONS) UNDER THE SECTION 8 AND PUBLIC HOUSING PROGRAMS (NEW CONSTRUCTION AND SUBSTANTIAL REHABILITATION)

1975-84

```
1975
  Reservations     76122  ****************
  Starts           24532  *****
  Occupancies      47674  **********

1976
  Reservations    199227  ******************************************
  Starts           55222  ************
  Occupancies      93371  ********************

1977
  Reservations    226832  ************************************************
  Starts          118386  *************************
  Occupancies      31193  *******

1978
  Reservations    190554  *****************************************
  Starts          170231  ************************************
  Occupancies      86275  ******************

1979
  Reservations    234700  **************************************************
  Starts          175119  *************************************************
  Occupancies     144874  ****************************************

1980
  Reservations    141758  ***************************************
  Starts          173249  ************************************************
  Occupancies     150394  ******************************************

1981
  Reservations    122674  **********************************
  Starts          106035  *****************************
  Occupancies     180057  **************************************************

1982
  Reservations     45908  ****************
  Starts          112931  ****************************************
  Occupancies     138714  *************************************************

1983 HUD Estimate
  Reservations     16600  ******
  Starts           72000  **************************
  Occupancien     141000  **************************************************

1984 HUD Estimate
  Reservations     10000  ****
  Starts           45000  ******************
  Occupancies     124963  **************************************************
```

Source: Low Income Housing Information Service (based on information in HUD Budget Summaries.

CHART IV.

HOUSING PAYMENTS, BUDGET AUTHORITY, AND HOUSING-RELATED TAX SUBSIDIES, 1980-84,
(In Millions of dollars

1980		
Tax subsidies	26461	********************************
Budget authority	26680	********************************
Housing payments	4529	*****
1981		
Tax subsidies	33330	**
Budget authority	30170	************************************
Housing payments	5747	*******
1982		
Tax subsidies	36625	**
Budget authority	17374	*********************
Housing payments	6880	********
1983		
Tax subsidies	39760	***
Budget authority	8652	**********
Housing payments	7774	*********
1984		
Tax subsidies	42835	***
Budget authority	515	*
Housing payments	8532	**********

Source: Compiled by Low Income Housing Information Service from Federal Budget documents.

proposed in the 1984 budget is not a net additional. More than half of the funds come from carry-over balances, meaning that funds were already provided in prior years. So the net increase is closer to 45,000 units. At this rate, it would take 150 years to provide assistance for just the renter households in 1980 who met the Administration's proposed criteria for need and eligibility.

NO COUNTING FOOD STAMPS AS INCOME

The proposal to count food stamps as income in determining eligibility and rents for assisted housing would be devastating to the poorest households in assisted housing. Some 43% percent of all low income housing tenants also receive food stamps. The increase would be at least 27% of the value of their food stamps: the lower their incomes, the more dependent they are on food stamps, and the higher their rent increase.

Moreover, the impact will vary greatly from state to state for households on public assistance. As Table 4 shows, the full increase from this change would range from $28.35 per month (a 25% rent increase) in Connecticut to $53.73 in states with maximum food stamp grants (with rent increases for these ten states varying from a low of 75% in Oregon to a high of 947% in Mississippi)

The increases shown in the table are full increases, without taking into account either the 10% cap now in the law or the 20% cap proposed by the Administration. We urge that the higher cap be rejected. In 1981, this Committee accepted a proposed 20% rent increase for all assisted housing tenants: changing the basic charge from 25% to 30% of income. While we disagreed with this increase, and again urge that it be repealed, we believe the Committee did the right thing to phase it in over five years. Even the 10% cap, which this Committee placed in the 1981 act to forestall unfair and insupportable results from other increases, permits a greater rate of increase. To double it would be wrong.

We call your attention to a series of rent increases which the Administration is attempting to impose by regulation. These include changes in the definition of income, to eliminate deduction or exclusion of extraordinary medical expenses and day care expenses and a change in the way Fair Market Rents (FMR's) are calculated in the Section 8 Existing program. We urge that the Committee, as it did last year, report legislation requiring deduction of medical and day care expenses from income and that it further require that FMR's or payment standards be set at levels which in fact will permit certificate holders to obtain housing within the payment standard unless they chose to do otherwise. Until experience proves otherwise, we believe that the appropriate standard is the one now in use: the median rent of recently available units of the size needed in the market area. To set the standard lower not only is unrealistic, it intensifies competition for the less expensive units between voucher holders and those still without vouchers.

TABLE 4. ESTIMATED IMPACT OF COUNTING FOODSTAMPS AS INCOME
AFDC SINGLE PARENT, 3 CHILDREN, 1983

STATE	(a) Maximum AFDC Grant	(b) Food Stamp Benefit	(c) Rent at 27% of AFDC	(d) Rent w/food stamps	(e) Dollar increase	(f) Percent increase	(g) Cash remaining AFDC rent	(h) AFDC+ fd stmps	(i) Daily AFDC only	(j) cash left AFDC+fd stmps
Alabama	118.00	199.00	11.61	65.34	53.73	462.79	106.39	52.66	3.55	1.76
Alaska	614.00	163.00	145.53	189.54	44.01	30.24	468.47	424.46	15.62	14.15
Arizona	233.00	189.00	42.66	93.69	51.03	119.62	190.34	139.31	6.34	4.64
Arkansas	140.00	199.00	17.55	71.28	53.73	306.15	122.45	68.72	4.08	2.29
California	506.00	107.00	116.37	145.26	28.89	24.83	389.63	360.74	12.99	12.02
Colorado	313.00	165.00	64.26	108.81	44.55	69.33	248.74	204.19	8.29	6.81
Connecticut	513.00	105.00	118.26	146.61	28.35	23.97	394.74	366.39	13.16	12.21
Delaware	266.00	179.00	51.57	99.90	48.33	93.72	214.43	166.10	7.15	5.54
Dist/Columbia	300.00	169.00	60.75	106.38	45.63	75.11	239.25	193.62	7.98	6.45
Florida	209.00	196.00	36.18	89.10	52.92	146.27	172.82	119.90	5.76	4.00
Georgia	194.00	199.00	32.13	85.86	53.73	167.23	161.87	108.14	5.40	3.60
Hawaii	468.00	198.00	106.11	159.57	53.46	50.38	361.89	308.43	12.06	10.28
Idaho	305.00	167.00	62.10	107.19	45.09	72.61	242.90	197.81	8.10	6.59
Illinois	302.00	168.00	61.29	106.65	45.36	74.01	240.71	195.35	8.02	6.51
Indiana	255.00	182.00	48.60	97.74	49.14	101.11	206.40	157.26	6.88	5.24
Iowa	360.00	151.00	76.95	117.72	40.77	52.98	283.05	242.28	9.44	8.08
Kansas	364.00	150.00	78.03	118.53	40.50	51.90	285.97	245.47	9.53	8.18
Kentucky	188.00	199.00	30.51	84.24	53.73	176.11	157.49	103.76	5.25	3.46
Louisiana	190.00	199.00	31.05	84.78	53.73	173.04	158.95	105.22	5.30	3.51
Maine	325.00	161.00	67.50	110.97	43.47	64.40	257.50	214.03	8.58	7.13
Maryland	295.00	178.00	59.40	107.46	48.06	80.91	235.60	187.54	7.85	6.25
Massachusetts	379.00	145.00	82.08	121.23	39.15	47.70	296.92	257.77	9.90	8.59
Michigan	483.00	141.00	110.16	148.23	38.07	34.56	372.84	334.77	12.43	11.16
Minnesota	446.00	125.00	100.17	133.92	33.75	33.69	345.83	312.08	11.53	10.40
Mississippi	96.00	199.00	5.67	59.40	53.73	947.62	90.33	36.60	3.01	1.22

NO SALE OR CONVERSION OF SUBSIDIZED PROJECTS OR UNDERMINING TENANT RIGHT

The Administration is proposing repeal of the requirement that HUD-foreclosed multifamily projects be retained as subsidized housing upon disposition. It is also proposing demolition or disposition of about 100,000 public housing units. We strenuously oppose both of these proposals. A time of increasing housing need is not the time to get rid of what little assisted housing we have. If there are isolated cases where there is no need or where the housing is truly not viable, then there should be one-for-one replacement by units of the same size as those let go or destroyed.

We also urge this Committee to strengthen the legislative language to prohibit HUD from abandoning the protections against evictions and other rights which had been provided under the public housing lease and grievance procedures -- developed under the Nixon Administration by a working group of housing authority administrators and tenants -- which are now to be substantially abandoned under HUD's proposed new rules.

CONTINUED CONSTRUCTION AND REHABILITATION OF HOUSING UNITS EARMARKED AND SUBSIDIZED FOR LOW INCOME PEOPLE

Last year, the President's Commission on Housing discovered, to its surprise, that for the most part it would be cheaper to house people in existing public housing projects than to provide vouchers. Why? Because the projects were built when costs were lower and present costs reflect this. And, although new construction may seem expensive today, the same thing is certain to happen several decades from now. Moreover, the present stock of rental housing does not fit the needs of low income people: those who need assistance most are large families and elderly or handicapped people.

In its justification for the rental rehabilitation program, HUD stated that there are 1.8 million seriously deficient rental units in the inventory, along with another 2.6 million units with specific inadequacies. To deal with that need, a program estimated at 30,000 units a year is proposed with no assurance that the improved units will in fact be occupied by lower income people. At this rate, the present need would be met in 146 years or, if there were some way to target aid to the worst units, they could be rehabbed in 60 years.

Experience with a variety of programs and approaches, from Section 8 to welfare shelter allowances, should have taught us that we cannot rely on market forces to provide adequate housing for low income people. The rental rehabilitation approach will only work for a multitude of nonprofit and community based groups now involved in housing rehabilitation for low income people if the vouchers, which make the after-rehab rents affordable, can be tied to the units. Otherwise, financing cannot be obtained.

We commend the Committee for the changes made in the Administration proposal last year, specifically those increasing the funding provided and the inclusion of new construction. We urge, again, that new construction be permitted under the program and an additional, critical program constraint: ALL of the funds provided must be used to provide housing for low and moderate income people, with a specific requirement that at least half be for very low income people. This will mean either requiring or giving local communities and states the flexibility to tie vouchers to specific units. Moreover, this requirement cannot be limited to initial rent-up; it needs to run for the subsidy period and be monitored to assure that it is being followed.

In addition, because it has demonstrated that it is the only assisted housing program which has been able to provide a significant volume of units for hard-to-house low income families, the public housing program should be reauthorized.

REAUTHORIZE THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM FOR ANOTHER THREE YEARS AT A DECENT FUNDING LEVEL AND KEEP IT TARGETED ON LOW AND MODERATE INCOME PEOPLE.

The Community Development Block Grant program has proven its value to low income people and neighborhoods. Experience has also proven, however, that it takes federal standards to assure that targeting requirements are met. The 1981 legislative history should be clear that, in simplifying the program, this Committee and the Congress did not intend to abandon the requirement of principal benefit to low and moderate income families. In reauthorizing the program, this should be made crystal clear and the language should apply both to the entitlement and to the "States Program". The statute should also prohibit use of CDBG funds in ways which result in displacement of lower income families by public or private action. Finally, we oppose relaxing the present restrictions on construction of housing with CDBG funds. Siphoning CDBG money away from housing rehabilitation as the only way of providing support for new construction simply does not make sense to us.

BOTH EMERGENCY AND LONG-TERM ASSISTANCE ARE NEEDED FOR THE HOMELESS

Homelessness is the tip of the iceberg of low income housing needs. The ultimate answer is to provide adequate shelter for all. The immediate need for emergency assistance appears to be being addressed, though inadequately in our view. We urge that any emergency assistance program be limited to provision of additional facilities, to avoid substitution, and that it be allocated in large part by formula to local governments with clear intent that they give priority to support of groups now working on the problem.

Beyond that, there is a need for something more than emergency shelters. For those who are homeless simply because they are without funds, an emergency special authorization of Section 8 Existing certificates should be provided. The Coalition, and some of our member organizations who focus on homelessness, is also exploring what additional measures are needed.

CONCLUSION

In addressing low income housing issues, we urge this Committee to remember three things:

- The housing needs of low income people are desperate and growing.
- Low income housing programs have already been cut far more than other low income programs.
- Housing subsidies for middle and upper income people are untouched, and still increasing.

Most important, housing is not just bricks and mortar. And in dealing with housing issues we should ask ourselves not just how many units we will have, but how our families should live and what kinds of communities and neighborhoods they should live in.

SPECIAL MEMORANDUM

Low Income Housing Information Service

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THE 1984 REAGAN BUDGET AND LOW INCOME HOUSING

With softened rhetoric, in comparison with last year and the year before, President Reagan submitted his 1984 budget to the Congress late in January. It is essentially a "stay the course" budget: continuing an expansion of military spending and proposing deep cuts in programs for low income people. This Special Memorandum describes the housing proposals in the context of the overall budget and of low income housing needs. It includes a series of tables and a glossary of budget and housing terms. [Note: Feel free to reproduce this in whole or in part. We would appreciate appropriate credit or acknowledgement.]

THE LOW INCOME HOUSING PROPOSALS IN BRIEF

The Administration again proposes to devastate low income housing programs. The budget is slightly less draconian than last year's for the Department of Housing and Urban Development (HUD), but it is worse for the rural housing programs of the Farmers Home Administration (FmHA).

To understand the HUD low income housing budget — and the claims and counterclaims that are made about what has been happening and what is proposed — it is important to keep in mind the distinction between housing payments and new budget authority.

> Housing payments are the subsidies for all the units (regardless of program) which HUD now assists. Housing payments are set by contracts made in the past. Thus, they are uncontrollable: as long as the contracts are in force, the payments will come due and must be made. Part of the emphasis on rent increases is to reduce the amounts that will be owed under these contracts. With the possible exception of some Section 8 Existing units, all of the subsidized housing now occupied was provided under prior administrations. When the Administration states, as it has on several occasions, that it has not cut housing payments, it is right because these payments result from actions taken before President Reagan assumed office.
>
> New budget authority is the amount provided for expanding low income housing assistance. It represents the cost of the subsidy contracts that will be entered into for the full life of the contracts. Some of the budget authority appropriated in 1984 will not be spent until the next century; the bulk of it will be spent in the 1990's; little if any will be spent in 1984 because the payments do not begin until the units are occupied. When the Administration states, as it has, that none of its proposed low income housing reductions will have any 1984 impact, it is again technically correct: the low income housing cuts will be reflected in future years.

Direct expenditures, or commitments to spend, are, however, only a small part of the "housing budget." There are also federal lending or mortgage insurance programs, mainly for middle income people, and housing-related tax expenditures, primarily the homeowner mortgage interest and property tax deductions. The 1980-84 pattern is striking. While tax expenditures will have increased by 62%, budget authority will have dwindled to almost nothing, and outlays will have been rising substantially, though far less dramatically than tax subsidies.

```
     HOUSING TAX SUBSIDIES, NEW BUDGET AUTHORITY AND HOUSING PAYMENTS, 1980-84
                             (Millions of dollars)
1980
  Tax subsidies     26461  *********************************
  Budget authority  26680  *********************************
  Housing payments   4529  *****
1981
  Tax subsidies     33330  *****************************************
  Budget authority  30170  *************************************
  Housing payments   5747  *******
1982
  Tax subsidies     36625  *********************************************
  Budget authority  17374  *********************
  Housing payments   6880  ********
1983
  Tax subsidies     39760  *************************************************
  Budget authority   8652  **********
  Housing payments   7774  *********
1984
  Tax subsidies     42835  *****************************************************
  Budget authority    515  *
  Housing payments   8532  **********
```

The Budget proposes a 94% cut in the level of new HUD budget authority for assisted housing. Last December, Congress provided $8.6 billion for low income housing for 1983; the Administration proposes only $515 million for 1984. Otherwise, the modest expansion of low income housing assistance (90,000 net additional units) will be supported by (a) a $3.1 billion deferral of 1983 funds and (b) recapture of funds appropriated in earlier years.

The level of new budget authority for HUD's low income housing programs is only 1.9% of the level provided when President Reagan took office. Indeed, it is only 2.1% of the $23.9 billion level proposed by President Ford in the budget he submitted to Congress just days before leaving office. Moreover, these are "current dollar" comparisons. Allowing for inflation, it is 1.3% of the last Ford budget request and 1.5% of the 1980 level.

The minuscule expansion in new budget authority is offset by a further rescission of low income housing funds "saved" by conversion of rent supplement units to Section 8. So the net amount of assistance (subtracting the $515 million in new money from a $2.8 billion rescission) is -$2.3 billion — the only minus figure for any major program in the entire federal budget.

The Administration is again proposing to count food stamps as income in determining rents and eligibility for low income housing. About half the households in public housing or Section 8 receive food stamps; they are the poorest low income housing tenants, and this proposal would increase their rents by 27% of the value of their food stamps, with the greatest absolute increases falling on the poorest tenants, since they have the highest food stamp allotments. This change requires amending the food stamp law.

While there are no other rent increases proposed in the budget itself, HUD has proposed regulations making two major program changes which would also increase housing costs for subsidized tenants. The first changes the manner in which income is calculated, to eliminate most current deductions and exclusions (such as day care expenses for working mothers and extraordinary medical expenses). The second would reduce the amount of the subsidy available under the Section 8 existing program (a "housing voucher" program which has been in effect since 1974 and which now assists over one-half million households). This is to be done by reducing the base for calculating the "fair market rents" (FMRs) which determine the subsidy amount and then letting tenants pay the extra (or, if they can find cheaper units, keep the saving).

In other modifications to the Section 8 Existing program, the Administration is proposing to shorten the contract term from 15 years to 5 years. This gives a paper saving, since the budget authority for low income housing programs equals the annual cost multiplied by the term of the contract. So this change reduces budget authority by two-thirds; it also means a substantial jump in costs in 1989, when the contracts expire, instead of deferring contract renewals to 1999. Alternatively, the full amount appropriated for 1983, if used as proposed by the Administration, could fund 364,000 households instead of 67,000 households.

In a change from last year's proposals, the Administration is now willing to allow annual subsidy adjustments for cost increases, but these are to be paid for by attrition in program level. In other words, if there is an average increase of 5% per year in fair market rents, by the end of the five years, there would be only 65,816 households receiving payments, instead of the 80,000 initially assisted. Again, this results in a paper saving, since Section 8 existing costs are now calculated with a reserve built in to cover future cost increases.

The Administration also proposes a change in how public housing operating subsidies are to be calculated. These subsidies are intended to cover the difference between income from tenant rents and the cost of operating public housing projects. The new proposal is to base the subsidies on "fair market rents" in the community, not on the cost of operating the projects. Moreover, after a phase-in period, operating and modernization subsidies would be combined. The immediate effect of this proposal is to increase 1984 public housing operating subsidies by one quarter while simultaneously reducing modernization funding by 45%, for a net reduction of 11% in the combined programs.

The Indian housing program would be ended, to be replaced by an allocation of $76 million to be used by Indian tribes for construction writedowns, rental assistance certificates, or both. HUD estimates 1000 units will get both, and 500 more will get construction writedowns, but use of the funds will be up to the tribes. Accompanying this will be some modifications in FHA insurance programs in an effort to make them workable on Indian reservations for people who might then be able to afford unassisted housing and a $44 million increase (to a total of $75 million) in CDBG funds for Indian tribes.

The budget reflects the Administration's contention that there is no need in this country for additional housing units built or rehabilitated specifically for low income people. Thus, the only new housing would be 10,000 units for elderly and handicapped people (under the Section 202 program). No other new or rehabilitated housing would be provided under the public housing or Section 8 programs. Moreover, the Section 8 moderate rehabilitation program would be ended immediately (with the funds approved by Congress for 15,000 units in 1983 deferred to 1984 and put to other use). The Administration does propose the same $30 million rental rehabilitation block grant program it recommended last year and it would make it easier to use CDBG funds to build housing (but would not provide more funds).

The Community Development Block Grant (CDBG) program is to be merged with General Revenue Sharing over a five year period. Each year, one-fifth of the funds could be transferred from CDBG to any other use by the recipient locality. Meanwhile, funding for the program would be reauthorized for another three years at the present $3.5 billion level.

The rural housing programs of the Farmers Home Administration would be wiped out and replaced by a proposed Rural Housing Block Grant. The only exception is the Farm Labor Housing grant program (which would receive $4.4 million). The budget also would allow $300 million from the Rural Housing Insurance Fund to be used, primarily to service the present portfolio of FmHA housing loans.
Only 3,038 additional units would be assisted by FmHA in 1984.

THE BUDGET CONTEXT

The 1984 budget falls midway in President Reagan's term of office. Changes since 1980, the last full year of the Carter Administration, are dramatic, particularly in budget authority. Outlay changes lag for many programs -- which means that in some areas, including low income housing, we have not yet begun to feel the full bite of budget cuts already made.

Table A is an effort to try to show what has been happening in the broader budget context. It shows changes in each major area (or "function") of the budget from 1980 through the Administration's proposals for 1986 in constant dollars -- that is, allowing for inflation. The major increases are in military spending, which rose by 29% between 1980 and 1982, but is slated for a 77% increase in constant dollars between 1980 and 1986. The only other major increases are in health care (primarily Medicare), Social Security, and interest on the national debt.

Low income housing leads the cuts in all other programs, except energy, where the 1980 figure hit a one-time high because of the Synfuels appropriation. But 1982, the year of cuts we have just lived through, is only the beginning of the cuts that will be made if the Administration has its way.

The shift in national priorities is indicated by the changing shares of the federal budget accounted for by military spending, by entitlements (chiefly social security and medicare), by interest on the debt, and by "all other" which is the whole range of nonmilitary, nonentitlement activities of the federal government.

PERCENT SHARES	1981	1984	1985	1986
MILITARY	24.3	28.3	30.5	32.1
Entitlements	44.4	42.1	41.9	41.8
Interest	10.5	12.0	12.3	12.3
All other	20.8	17.6	15.3	13.8

ESTIMATED BUDGET AUTHORITY IN CONSTANT 1972 DOLLARS
FOR MAJOR FUNCTIONS AND SELECTED SUBFUNCTIONS AND PROGRAMS (Dollars in millions)

TABLE A

FUNCTION, SUBFUNCTION, OR	1980 Estimate	1982 Estimate	% Change 1980-82	1984 Estimate	% Change 1982-84	% Change 1980-84	1986 Estimate	Change 1980-86	% Change 1980-86
National Defense	81798	105552	29.04	122277	15.85	49.49	144945	63147	77.20
International Affairs	8719	7368	-15.49	7329	-0.53	-15.94	6269	-2450	-28.10
Genl Science, Space, Tech	3446	3409	-1.07	3684	8.07	6.91	3073	-373	-10.82
Energy	20453	1574	-92.30	1251	-20.52	-93.88	1229	-19224	-93.99
Natural Resources/Environment	7324	5405	-26.20	3882	-28.18	-47.00	3458	-3866	-52.79
Agriculture	2775	9056	226.34	5878	-35.09	111.82	3280	505	18.20
Commerce & Housing Credit	5891	3098	-47.41	3291	6.23	-44.14	1805	-4086	-69.36
Mortgage credit/thrift ins	3637	1957	-46.19	2482	26.83	-31.76	1081	-2556	-70.28
GNMA mortgage purchases	1049	531	-49.38	0	-100.00	-100.00	0	-1049	-100.00
FHA mortgage credit	182	98	-46.15	55	-43.88	-69.78	57	-125	-68.68
Hsg for elderly/handicappe	452	343	-24.12	190	-44.61	-57.96	222	-230	-50.88
FmHA rural housing	1281	967	-24.51	657	-32.06	-48.71	786	-495	-38.64
Postal Service	941	341	-63.76	174	-48.97	-81.51	159	-782	-83.10
Transportation	11341	10259	-9.54	12110	18.04	6.78	11666	325	2.87
Community/regional development	5673	3187	-43.82	2646	-16.98	-53.36	2710	-2963	-52.23
Community development	2765	2071	-25.10	1831	-11.59	-33.78	1762	-1003	-36.27
Community devel block gran	2105	1668	-20.76	1526	-8.51	-27.51	1391	-714	-33.91
Urban devel action grants	379	229	-39.58	85	-62.88	-77.57	175	-204	-53.83
Area/regional development	1566	958	-38.83	775	-19.10	-50.51	796	-770	-49.17
Rural development	363	285	-21.49	388	36.14	6.89	399	36	9.92
Econ devel asstc	310	108	-65.16	8	-92.59	-97.42	3	-307	-99.03
Indian programs	664	558	-15.96	471	-15.59	-29.07	489	-175	-26.36
Disaster relief/insurance	1361	175	-87.14	56	-68.00	-95.89	165	-1196	-87.88
Educ, Traing, Emplymt, Soc Svc	17184	12476	-27.39	11177	-10.41	-34.96	9921	-7263	-42.27
Elementary/secondary/voc ed	4054	3090	-23.78	2629	-14.92	-35.15	2398	-1656	-40.90
Educ for disadvantaged	2018	1468	-27.25	1314	-10.49	-34.89	1197	-821	-40.68
Higher education	3218	3572	11.00	2704	-24.30	-15.97	2455	-763	-23.71
Training and employment	5400	2127	-60.60	2372	11.05	-56.07	1840	-3560	-65.93
Social services	3451	2941	-14.78	2823	-4.01	-18.20	2651	-800	-23.18
Social services block gran	1584	1158	-26.89	1090	-5.87	-31.19	1073	-511	-32.26
Community service progs	309	182	-41.10	1	-99.45	-99.68	0	-309	-100.00
Health	33582	38059	13.33	39985	5.06	19.07	44620	11038	32.87
Health care services	30471	35458	16.37	37457	5.64	22.93	42326	11855	38.91
INCOME SECURITY	125813	122676	-2.49	123879	0.98	-1.54	136890	11077	8.80
General retirement/disabilit	68609	73994	7.85	78957	6.71	15.08	90875	22266	32.45
Federal employee retirement	13879	15572	12.20	16531	6.16	19.11	17705	3826	27.57
Unemployment compensation	9934	10221	2.89	13031	27.49	31.18	12269	2335	23.51
HOUSING ASSISTANCE	15608	6697	-57.09	173	-97.42	-98.89	1877	-13731	-87.97
SUBSIDIZED HOUSING	--	5910	--	-1011	-117.11	--	816	--	--
Food/nutrition assistance	7730	7618	-1.45	7106	-6.72	-8.07	6607	-1123	-14.53
Food stamps	5153	5447	5.71	5112	-6.15	-0.80	4690	-463	-8.99
Child nutrition, other pro	2577	2171	-15.75	1995	-8.11	-22.58	1918	-659	-25.57
Other income security	10053	8576	-14.69	8082	-5.76	-19.61	7556	-2497	-24.84
Supplemental security inco	3630	3750	3.31	3126	-16.64	-13.88	3461	-169	-4.66
AFDC and related astc	4326	2899	-32.99	3274	12.94	-24.32	2990	-1336	-30.88
Low income energy asstc	908	905	-0.33	567	-37.35	-37.56	516	-392	-43.17
Veterans Benefits/Services	11901	12057	1.31	11390	-5.53	-4.29	11042	-859	-7.22
Administration of Justice	2464	2277	-7.59	2442	7.25	-0.89	2157	-307	-12.46
General Government	2582	2399	-7.09	2639	10.00	2.21	2492	-90	-3.49
General Purpose Fiscal Asstc	4864	3085	-36.57	3036	-1.52	-37.54	2803	-2061	-42.37
General Revenue Sharing	3850	2207	-42.68	1994	-9.65	-48.21	1818	-2032	-52.78
Net Interest	36200	40877	12.92	44978	10.03	24.25	48745	12545	34.65
Interest on public debt	41965	56559	34.78	62990	11.37	50.10	71275	29310	69.84
TOTAL BUDGET AUTHORITY	369691	376412	1.82	392376	4.24	6.14	428923	59232	16.02

Source: Low Income Housing Information Service

TABLE B. BUDGET AUTHORITY, 1983 AND 1984, FOR FUNCTIONS AND SELECTED SUBFUNCTIONS (IN MILLIONS OF DOLLARS)

FUNCTION OR SUBFUNCTION	1983 Estimate	1984 Admin	1983-84 Change	% Change 1983-84	% Share 1983	% Share 1984
National Defense	245474	280503	35029	14.27	28.97	31.16
International Affairs	17066	16813	-253	-1.48	2.01	1.87
Genl Science, Space, Tech	7912	8451	539	6.81	0.93	0.94
Energy	3725	2869	-856	-22.98	0.44	0.32
Natural Resources/Environment	11234	8906	-2328	-20.72	1.33	0.99
Agriculture	18160	13484	-4676	-25.75	2.14	1.50
Commerce & Housing Credit	4915	7556	2641	53.73	0.58	0.84
Mortgage credit/thrift ins	2435	5694	3259	133.84	0.29	0.63
GNMA mortgage purchases	2	1	-1	-50.00	0.00	0.00
FHA mortgage credit	183	127	-56	-30.60	0.02	0.01
Hsg for elderly/handicappe	564	436	-128	-22.70	0.07	0.05
FmHA rural housing	1630	1508	-122	-7.48	0.19	0.17
Postal Service	789	400	-389	-49.30	0.09	0.04
Transportation	26692	27780	1088	4.08	3.15	3.09
Ground transportation	18869	19062	193	1.02	2.23	2.12
Community/regional development	6592	6071	-521	-7.90	0.78	0.67
Community development	4367	4200	-167	-3.82	0.52	0.47
Community devel block gran	3456	3500	44	1.27	0.41	0.39
Urban devel action grants	440	196	-244	-55.45	0.05	0.02
Area/regional development	2003	1777	-226	-11.28	0.24	0.20
Rural development	777	890	113	14.54	0.09	0.10
Econ devel asstc	34	18	-16	-47.06	0.00	0.00
Indian programs	1135	1080	-55	-4.85	0.13	0.12
Disaster relief/insurance	256	128	-128	-50.00	0.03	0.01
Educ, Traing, Emplymt, Soc Svc	25996	25640	-356	-1.37	3.07	2.85
Elementary/secondary/voc ed	6402	6030	-372	-5.81	0.76	0.67
Educ for disadvantaged	3034	3014	-20	-0.66	0.36	0.33
Higher education	6444	6202	-242	-3.76	0.76	0.69
Training and employment	5175	5441	266	5.14	0.61	0.60
Social services	6350	6475	125	1.97	0.75	0.72
Social services block gran	2450	2500	50	2.04	0.29	0.28
Community service progs	359	3	-356	-99.16	0.04	0.00
Health	67558	91725	24167	35.77	7.97	10.19
Health care services	61798	85927	24129	39.04	7.29	9.55
INCOME SECURITY	301328	284178	-17150	-5.69	35.56	31.57
General retirement/disabilit	189808	181127	-8681	-4.57	22.40	20.12
Federal employee retirement	35440	37922	2482	7.00	4.18	4.21
Unemployment compensation	31884	29892	-1992	-6.25	3.76	3.32
HOUSING ASSISTANCE	5660	397	-5263	-92.99	0.67	0.04
SUBSIDIZED HOUSING	4267	-2319	-6586	-154.35	0.50	-0.26
Food/nutrition assistance	17747	16302	-1445	-8.14	2.09	1.81
Food stamps/Puerto Rico ai	12815	11726	-1089	-8.50	1.51	1.30
Child nutrition, other pro	4932	4576	-356	-7.22	0.58	0.51
Other income security	20789	18539	-2250	-10.82	2.45	2.06
Supplemental security inco	8544	7170	-1374	-16.08	1.01	0.80
AFDC and related astc	8223	7511	-712	-8.66	0.97	0.83
Low income energy asstc	1986	1300	-686	-34.54	0.23	0.14
Veterans Benefits/Services	25002	26129	1127	4.51	2.95	2.90
Administration of Justice	5245	5602	357	6.81	0.62	0.62
General Government	5682	6055	373	6.56	0.67	0.67
General Purpose Fiscal Asstc	6330	6969	639	10.09	0.75	0.77
General Revenue Sharing	4574	4574	0	0	0.54	0.51
Net Interest	88935	103180	14245	16.02	10.49	11.46
Interest on public debt	128063	144500	16437	12.84	15.11	16.05
TOTAL BUDGET AUTHORITY	847433	900110	52677	6.22	100.00	100.00

Source: Low Income Housing Information Service

Table B compares, in "current" dollars (not adjusted for inflation) the 1983 and proposed 1984 budget levels. Total budget authority of just over $900 billion is up by $53 billion from 1983. The military increase is $35 billion; health care costs are up by $24 billion, with most of this coming from higher Medicare costs, and interest is up by $14 billion -- a reflection of the rising deficit. Offsetting these increases are cuts in just about every other area of the budget. Military spending, which was 22.1% of the federal budget in 1980, is scheduled to be over 31% in 1984. Subsidized housing, 4% of all budget authority in 1980, is -0.3% in 1984 because of the rescissions.

The budget projects huge deficits in 1983, 1984 and future years, and concern about these deficits will clearly influence Congressional response to the budget. The level of spending is, however, only one factor in determining the deficit. The budget itself contains an analysis of the sensitivity of federal receipts to economic growth; other major influences are unemployment and interest rates. And, as the following table shows, the 1981 tax cut has made a huge difference.

	1982	1983	1984	1985	1986	1982-86
Budget receipts	671.8	597.5	659.7	724.3	841.9	3495.2
Budget outlays	728.4	805.2	848.5	918.5	989.6	4290.2
Deficit	-110.6	-207.7	-188.8	-194.2	-147.7	-849.0
1981 tax cut (ERTA)	-35.6	-82.6	-130.3	-158.2	-202.3	-609.0
Deficit without ERTA	-75.0	-125.1	-58.5	-36.0	54.6	-240.0
1982 tax reform (TEFRA)	--	17.3	38.3	42.2	52.1	149.9
1982 highway tax	--	1.7	3.8	3.9	3.9	13.2
Deficit/surplus without ERTA, but with 1982 law	-75.0	-106.1	-16.4	10.1	110.6	-76.9

The deficits, plus the unprecedented interest rates of the past two years, have led to a major increase in interest payments on the federal debt: from $75 billion in 1980 to an anticipated $145 billion in 1984. A twofold attack on the problem appears to be shaping up: continued reductions in spending (but with the Congressional focus this year far more on military spending) plus further tax increases, either by eliminating loopholes or postponing or capping the third year ERTA tax cut.

HOUSING NEEDS AND THE STATUS OF LOW INCOME HOUSING PROGRAMS

There is a lot of information and detail in the various volumes that comprise the Budget, but nowhere is there an effort to set forth what must be done to provide decent housing for low income people, or even any estimate of low income housing need. Herewith are a few facts, drawn primarily from data in the 1980 Annual Housing Survey, to provide the framework for considering and commenting on the budget.

The lowest responsible current estimate of low income housing need is contained in the April 1982 Report of the President's Commission on Housing, which states that there are a total of about 20 million households with incomes below 50% of median. One half, or 10 million, are renters. One quarter of these, or about 2.5 million, live in subsidized housing. Almost all the rest either live in substandard housing or pay more than they can afford for shelter. In other words, there are some 7.5 million renter households who need housing assistance. It is not clear how many of the 10 million owners with incomes below 50% of median also need housing assistance, but a substantial number clearly do.

In other words, by this reckoning, for each household now living in assisted housing, there are at least three others who need it. Other estimates of need are far higher: for example, there are some thirty million households with incomes below 80% of median, the standard of eligibility in use for low income programs throughout most of the last decade. Whatever the estimate, it is clear that we are far from reaching it, and falling constantly further behind.

Another way of dramatizing housing need is to compare the number of households, by income bracket, with the number of units that exist at rents they can afford. This approach grossly understates true housing need, since it leaves out any consideration whatever of housing quality, suitability, or availability. Nonetheless, as the chart shows, there are almost twice as many households in the very lowest income brackets as there are affordable units at 25% of income.

Income under $3000		
Households	2,748,000	**************
Units	1,252,000	******
Income $3000-4999		
Households	3,598,000	******************
Units	1,451,000	*******
Income $5000-6999		
Households	2,882,000	**************
Units	2,351,000	************
Income $7000-9999		
Households	3,862,000	*******************
Units	5,526,000	****************************
Income $10000-14999		
Households	5,553,000	****************************
Units	10,067,000	**
Income $15000-19999		
Households	3,672,000	******************
Units	4,464,000	**********************
Income $20000-24999		
Households	2,263,000	***********
Units	1,479,000	*******
Income $25000 or more		
Households	2,978,000	***************
Units	994,000	*****

Contrasted with this is the number of subsidized housing units. HUD provides the following estimates:

Program	1982 Actual	1983 Estimate	1984 Estimate
Section 8	1,526,683	1780,000	2,118,000
Section 235			
Old program	145,682	132,000	118,000
Revised progra	96,245	100,000	95,000
Section 236	536,531	536,000	535,000
Rent supplement	153,355	80,000	15,000
Public housing	1,224,000	1,250,000	1,255,000
Total	3,682,496	3,878,000	4,136,000
Less:			
236's with Section 8	-110,900	-147,000	-181,800
236's with rent sups	-63,700	-33,000	-6,200
TOTAL	3,507,896	3,698,000	3,948,000

In addition, we estimate that there are about 1,100,000 units receiving assistance through the various rural housing programs of the Farmer's Home Administration.

BUDGET TABLES, WITH COMMENTS AND EXPLANATION

TABLE 1. CHANGES IN HUD HOUSING PROGRAMS, 1980-84, SHOWING 1983-84 AND 1980-84 CHANGES. Table 1 compares, for the public housing and Section 8 programs, changes in funding levels and unit reservations. Actual figures are shown for 1980, 1981, and 1982. Then come three columns on 1983: the appropriation as enacted by Congress; HUD's proposed revision; and the differences between the two. The 1984 Administration request is followed by comparisons with the 1983 level (using the Administration's proposed revision) and with actual levels in 1980.

The differences in the number of units are underestimated because of a change in the basis for the figures: 1980 figures are net reservations (gross reservations adjusted for cancellations, etc); all later figures are gross reservations. An effort has been made to separate unit reservations which represent an addition to the stock of low income housing from those which substitute Section 8 assistance for subsidies now provided under other programs. Figures for the Section 202 elderly and handicapped housing program and the Indian housing program are in parentheses because they are included in the Section 8 new and public housing totals, respectively.

Note that the Administration is proposing deferral of $3.1 billion in budget authority from 1983 to 1984. New budget authority for low income housing would drop by 94%, from $8.6 billion in 1983 to $0.5 billion in 1984.

Moreover, in 1983, the Administration is proposing major changes in the Section 8 existing housing program. By regulation, it is proposing to lower fair market rents (to the 40th percentile of all rental housing, instead of the median rent of units becoming available -- a reduction of 15% to 20% in most markets). Legislation will be proposed to set the Section 8 subsidy at the difference between the tenant contribution and the fair market rent and to limit the contract to five years. The change in the subsidy would mean that tenants would pay less out of their own pockets if they found cheaper housing; more, if they didn't. With lowered fair market rents, few believe that any significant number of households will gain by this change; many will lose. The shortened contract term results in a paper saving, since budget authority (the cost of the program) is determined by the multiplying the annual cost by the length of the contract. So, there's a 67% "saving" by shortening the contract from 15 years to 5 years.

The table does NOT show the impact of another Administration proposal: that food stamps be counted as income in determining rents and eligibility for HUD subsidized housing, a proposal that was rejected by the Senate Agriculture Committee last year.

The bottom of the table shows the impact of a proposal to change public housing subsidies. Presently, there are three subsidies for public housing: (1) annual contributions to amortize the bonds financing the housing; (2) operating subsidies to cover the gap between income from rents and the costs of operations; and (3)modernization funds to retrofit and improve older projects. HUD proposes to base operating subsidies on fair market rents in the private market, rather than the cost of operating public housing and, eventually, to combine modernization and

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PROGRAM/ACTIVITY		(a) 1980 Actual	(b) 1981 Actual	(c) 1982 Actual	(d) 1983 Law	(e) 1983 HUD Revision	(f) 1983 Change	(g) 1984 Proposed	(h) Change 1983-84 Amount	(i) Change 1983-84 %	(j) Change 1980-1984 Amount	(k) Change 1980-1984 %
SECTION 8/PUBLIC HOUSING												
Budget Authority												
New budget authority	$	26680.1	30169.8	17373.5	8651.5	8651.5	0	514.7	-8136.8	-94.1	-26165.4	-98.1
Permanent authority	$	39.5	32.3	30.3	24.7	24.7	0	2[illegible]	-0.9	-3.6	-15.7	-39.7
Carryover balances	$	2531.7	2290.8	2772.1	2340.4	2340.4	0	0	--	--	-2531.7	-100.0
Recaptures	$	0	5226.9	2831.4	4600.0	4932.0	332.0	4346.3	--	--	4346.3	--
Subtotal	$	29251.3	37719.9	23007.2	15616.5	15198.5	-418.0	1884.8	-10313.4	-87.6	-27366.5	-93.6
Rescissions/deferrals	$	0	-5519	-4099	0	-3081	-3081	3081	--	--	3081	--
Total	$	29251.3	32200.7	18908.6	15616.5	12867.3	-2749.2	7966.0	-4901.3	-38.1	-21285.3	-72.8
Use of Budget Authority												
Section 8												
New const/sub rehab	$	10705.0	10245.2	3704.2	1942.0	1834.0	-108.0	1376.0	-458.0	-25.0	-9329.0	-87.1
Moderate rehab	$	0	0	551.4	1080.0	0	-1080.0	0	0	0	0	0
Existing/vouchers	$	4138.7	5791.2	1279.9	3762.0	641.9	-3140.1	916.8	274.9	42.8	-3221.9	-77.8
Loan management	$	--	--	184.9	0	187.5	187.5	75.0	-112.5	-60.0	75.0	--
Property disposition	$	--	--	551.6	684.0	1410.0	726.0	93.5	-1316.5	-93.4	93.5	--
Conversions, etc	$	--	313.7	2338.3	2668.5	2668.5	0	3354.7	686.2	25.7	3354.7	--
Amendments	$	3223.1	3007.3	4020.0	1406.2	1096.5	-309.6	391.0	-705.5	-64.3	-2832.1	-87.9
Subtotal	$	18067.1	19357.4	12630.3	11454.7	7946.5	-3508.2	6498.7	-1447.8	-18.2	-11568.4	-64.0
Public housing												
Conventional	$	3656.8	4195.7	1232.4	0	0	0	0	0	0	-3656.8	-100.0
Indian	$	847.9	471.5	494.3	361.8	361.8	0	0	-361.8	-100.0	-547.9	-64.6
Amendments	$	956.0	935.4	372.1	532.0	532.0	0	45.0	-487.0	-91.5	-911.0	-95.3
Lease/interest adjust	$	32.3	30.3	24.7	23.8	1437.8	1414.0	22.3	-1415.5	-98.4	-10.0	-30.9
Modernization	$	999.6	1699.2	1799.9	2589.3	2589.3	0	1400.0	-1189.3	-45.9	400.4	40.1
Subtotal, pub hsg (	$	6492.6	7332.0	3923.3	4161.9	4920.9	759.0	1467.3	-3453.6	-70.2	-5025.3	-77.4
Total obligations	$	24559.7	26689.4	16553.7	15616.5	12867.3	-2749.2	7966.0	-4901.4	-38.1	-16593.7	-67.6
Contract Authority												
Net new authority	$	1140.7	1417.4	897.2	519.7	519.7	0	408.7	-111.0	-21.4	-732.0	-64.2
Total authority	$	1182.7	1155.1	1045.6	922.5	821.5	-101.0	711.6	109.9	13.4	-471.1	-39.8
Section 8 units	U	(net)	(gross)	(gross	(gross)	(gross)	(gross)	(gross)	(gross)			
New/sub rehab	U	92763	73861	26973	14000	14600	600	10000	-4600	-31.5	-82763	-89.2
Section 202	U	(18720)	(15166)	(15400)	(14000)	(14000)	0	(10000)	(-4000)	-28.6	(-8720)	-53.4
Moderate rehab	U	26167	24901	6799	15000	0	-15000	0	0	0	-26167	-100.0
Existing/vouchers	U	50235	53947	23418	67146	67146	0	80000	12854	19.1	29765	59.3
Net addtl units	U	169165	152789	57190	96146	81746	-14400	90000	8254	10.1	-79165	-46.8
Conversions, etc	U	--	31342	76216	75000	91000	16000	114441	23441	25.8	114441	--
Total, Section 8	U	169165	184131	133406	171146	172746	1600	204441	31695	18.3	35276	20.9
Public Housing units	U	36727	36370	12136	2000	2000	0	0	-2000	-100.0	-36727	-100.0
Indian housing	U	(4893)	(3128)	(3192)	(2000)	(2000)	0	0	(-2000)	-100.0	(-4893)	-100.0
TOTAL/SECTION 8/PUB HSG	U	205892	220501	145542	173146	174746	1600	204441	29695	17.0	-1451	-0.7
NET ADDTL UNITS	U	205892	189159	69326	98146	83746	-14400	90000	6254	7.5	-115892	-56.3
Rescissions												
236 rental housing BA	$	--	--	--	-380.8	-380.8	0	-483.1	-102.3	26.9	-483.1	--
Rent supplement BA	$	-13.1	-143.5	-1059.5	-2830.4	-2830.4	0	-2374.8	455.6	-16.1	-2361.7	18028.1
Housing payment outlays	$	4529.3	5746.5	6880.2	7774.0	7774.0	0	8532.0	758.0	9.8	4002.7	88.4
Total assisted units	U	3105070	3297451	3507896	3698000	3698000	0	3948000	250000	6.8	842930	27.1
Pub hsg operating subs BA	$	755.0	1070.8	1493.5	1350.6	1281.6	-69.0	1636.5	354.9	27.7	881.5	116.8
Pub hsg modernization BA	$	999.6	1699.2	1799.9	2589.3	2589.3	0	1400.0	-1189.3	-45.9	400.4	40.1
Capital costs financed	$	545.3	926.9	857.6	1271.1	1271.1	0	687.3	-583.8	-45.9	142.0	26.0
Op subs + cap costs	$	1300.3	1997.7	2351.1	2621.7	2621.7	0	2323.8	-297.9	-11.4	1023.5	78.7

Source: Low Income Housing Informat(from information in HUD Budget Summaries, 1982-84)

TABLE 2. HUD LOW INCOME HOUSING PROGRAMS, 1980-84 (Dollars in millions)

Program/Activity		(a) 1980 Actual	(b) 1981 Actual	(c) 1982 HUD	(d) 1982 Actual	(e) Change HUD/Actual Amount	(f) Change HUD/Actual %	(g) 1983 Budget	(h) 1983 Law	(i) Change HUD/Law Amount	(j) Change HUD/Law %	(k) 1984 Proposed
SECTION 8/PUBLIC HOUSING												
Available Budget Authority												
New budget authority	$	26680.1	30169.8	17373.5	17373.5	0	0	0	8651.5	8651.5	--	514.7
Permanent authority	$	39.5	32.3	30.3	30.3	0	0	24.8	24.7	0.1	0.4	23.8
Carryover balances	$	2531.7	2290.8	2772.1	2772.1	0	0	0	2340.4	2340.4	--	0
Recaptures	$	0	5226.9	7483.8	2831.4	-4652.4	-62.2	9919.1	4600.0	-5319.1	-53.6	4346.3
Subtotal	$	29251.3	37719.9	27659.7	23007.2	-4652.5	-16.8	9943.9	15616.5	5672.6	57.0	1884.8
Rescissions/deferrals	$	0	-5519.1	-9399.8	-4098.6	5301.1	-56.4	-2451.5	0	2451.5	-100.0	3081.2
Total	$	29251.3	32200.7	18259.9	18908.6	648.7	3.6	7528.4	15616.5	8088.1	107.4	7966.0
Use of Budget Authority												
Section 8												
New constr/sub rehab	$	10705.0	10245.2	2906.6	3704.2	797.6	27.4	1310.0	1942.0	632.0	48.2	1376.0
Moderate rehab	$	0	0	0	551.4	551.4	--	0	1080.0	1080.0	--	0
Existing/vouchers	$	4138.7	5791.2	1310.1	1279.9	-30.2	-2.3	300.0	3782.0	3482.0	1160.7	916.8
Loan management	$	--	--	?	184.9	--	--	--	0	0	--	75.0
Property disposition	$	--	--	?	551.6	--	--	100.0	684.0	584.0	584.0	93.5
Conversions (existing	$	--	313.7	7162.2	2338.3	-4823.9	-67.4	894.6	2668.5	1773.9	198.3	3354.7
Amendments	$	3223.1	3007.3	3106.8	4020.0	913.2	29.4	1200.0	1406.2	206.2	17.2	391.0
Subtotal	$	18067.1	19357.4	14485.7	12630.3	-1855.4	-12.8	3804.6	11454.7	7650.1	201.1	6498.7
Public housing												
Conventional	$	3656.8	4195.7	22.5	1232.4	1209.9	5377.3	0	0	0	0	0
Indian	$	847.9	471.5	26.9	494.3	467.4	1738.8	0	361.8	361.8	--	0
Amendments	$	956.0	935.4	500.0	372.1	-127.9	-25.6	500.0	532.0	32.0	6.4	45.0
Lease/interest adjust	$	32.3	30.3	24.8	24.7	-0.1	0.4	23.8	23.8	0	0	22.3
Modernization	$	999.6	1699.2	1800.0	1799.9	-0.1	0	1800.0	2589.3	789.3	43.9	1400.0
Subtotal, pub hsg (	$	6492.6	7332.0	2374.2	3923.3	1549.2	65.3	2323.8	4161.9	1838.1	79.1	1467.3
Total obligations	$	24559.7	26689.4	16859.9	16553.7	-306.2	-1.8	6128.4	15616.5	9488.1	154.8	7966.0
Contract Authority												
Net new contract auth (	$	1140.7	1417.4	897.2	897.2	0	0	-2.1	519.7	521.8	25428.8	408.7
Total contract authorit	$	1182.7	1155.1	985.4	1045.6	60.2	6.1	507.8	922.5	414.7	81.7	711.6
Section 8 units	U	(net)	(gross)	(gross)	(gross	(gross)	(gross)	(gross)	(gross)	(gross)	(gross)	(gross)
New/sub rehab	U	92763	73861	22502	26973	4471	19.9	10000	14000	4000	40.0	10000
Section 202	U	(18720)	(15166)	(16933)	(15400)	(-1533)	(-9.1)	(10000)	(14000)	(4000)	(40.0)	(10000)
Moderate rehab	U	26167	24981	10720	6799	-3921	-36.6	0	15000	15000	--	0
Existing/vouchers	U	50235	53947	3385	23418	20033	591.8	30000	67146	37146	123.8	80000
Net addtl units	U	169165	152789	36607	57190	20583	56.2	40000	96146	56146	140.1	90000
Conversions, etc	U	--	31342	183000	76216	-103784	-56.7	81615	75000	-6615	-8.1	114441
Subtotal, Section 8	U	169165	184131	219607	133406	-86201	-39.3	121615	171146	49531	40.7	204441
Public Housing units	U	36727	36370	310	12136	11826	3814.8	0	2000	2000	--	0
Indian housing	U	(4893)	(3128)	(160)	(3192)	(3032)	(1895.0)	0	(2000)	(2000)	--	0
TOTAL SECTION 8/PUB HSG	U	205892	220501	219917	145542	-74375	-33.8	121615	173146	51531	42.4	204441
NET ADDTL UNITS	U	205892	189159	36917	69326	32409	87.8	40000	98146	58146	145.4	90000
Rescissions												
236 rental housing (BA	$	--	--	--	--	--	--	--	-380.8	-380.8	--	-483.1
Rent supplements (BA)	$	-13.1	-143.5	-2787.5	-1059.5	1728.0	-62.0	-2830.4	-2830.4	0	0	-2374.8
Housing payment outlays	$	4529.3	5746.5	6726.0	6880.2	154.2	2.3	7352.0	7774.0	422.0	5.7	8532.0
Total assisted units	U	3105070	3297451	3546700	3507896	-38804	-1.1	3668480	3698000	29520	0.8	3948000
Pub hsg operating subs BA	$	755.0	1070.8	1296.1	1493.5	197.4	15.2	1075.0	1350.6	275.6	25.6	1636.5
Pub hsg modernization BA	$	999.6	1699.2	1800.0	1799.9	-0.1	0	1800.0	2589.3	789.3	43.9	1400.0
Capital costs financed	$	545.3	926.9	981.9	857.6	-124.3	-12.7	981.9	1271.1	289.2	29.5	687.3
Op subs + cap costs	$	1300.3	1997.7	2278.0	2351.1	73.1	3.2	2056.9	2621.7	564.8	27.5	2323.8

Source: Low Income Housing Information Service (from information in HUD Budget Summaries, 1982-84)

HUD PROGRAMS OTHER THAN LOW INCOME HOUSING (Dollars in millions)

TABLE 3.

Program/Activity	1980 Actual	1981 Actual	1982 Actual	1983 Estimate	1984 Proposed	Change 1983-84	% Change 1983-84	Change 1980-84	% Change 1980-84
235 home ownrshp BA used	4658.7	1649.8	628.0	1017.9	0	-1017.9	-100.0	-4658.7	-100.0
Units reserved	58907	5102	4754	9000	0	-9000	-100.0	-58907	-100.0
202 elderly/hndicpd loans	831.2	872.6	818.8	634.2	476.0	-158.2	-24.9	-355.2	-42.7
Congregate services BA ($	6.7	0	0	4.0	0	-4.0	-100.0	-6.7	-100.0
Housing counseling ($)	9.0	7.0	3.5	3.5	0	-3.5	-100.0	-9.0	-100.0
Fair Housing/Equal Opportunity									
State/local agency aid	0.3	2.1	5.4	6.7	3.7	-3.0	-45.2	3.4	975.6
Agencies assisted	7	32	67	80	90	10	12.5	83	1185.7
Community Housing Resou	0	0	2.0	6.5	1.0	-5.5	-84.7	1.0	--
Number assisted	0	0	90	170	50	-120	-70.6	50	--
Title VIII complaints r	3039	4209	5112	4908	5350	442	9.0	2311	76.0
processed	2860	3931	4479	4618	5311	693	15.0	2451	85.7
Compliance reviews comp	603	549	346	362	362	0	0	-241	-40.0
Homesteading outlays ($)	7.5	7.0	11.6	20.4	12.0	-8.4	-41.1	4.5	60.8
Units conveyed	790	1165	796	1960	1268	-692	-35.3	478	60.5
312 rehab loan outlays ($	164.9	84.5	49.4	84.1	0	-84.1	-100.0	-164.9	-100.0
Single family loans	8887	3212	502	900	0	-900	-100.0	-8887	-100.0
Multifamily	295	134	255	420	0	-420	-100.0	-295	-100.0
Nonresidential	129	32	0	0	0	0	--	-129	-100.0
COMMUNITY DEVELOPMENT									
Community Devel Block Gra	3752.4	3694.6	3456.0	3456.0	3500.0	44.0	1.3	-252.4	-6.7
Urban Devel Action Grants	675.0	675.0	473.7	440.0	196.0	-244.0	-55.5	-479.0	-71.0
Rental rehab grants ($)	0	0	0	0	150.0	150.0	100.0	150.0	--
701 planning grants	39.0	15.8	0	0	0	0	-100.0	-39.0	-100.0
MORTGAGE INSURANCE/FINANCING									
Federal Housing Administration									
Insurance limitation ($	--	34155.0	40000.0	45900.0	39800.0	-6100.0	-13.3	--	--
Applications (units)	725998	550296	410558	907000	817000	-90000	-9.9	91002	12.5
Units insured	556346	408129	282038	713964	640874	-73090	-10.2	84528	15.2
Claims paid (units)	46695	46695	48594	48239	46486	-1753	-3.6	-209	-0.4
Claims paid ($)	615.9	788.5	890.2	1143.5	1151.1	7.5	0.7	535.2	86.9
TMAP (Temp mortgage ass	0	0	76.0	45.0	56.4	11.4	25.3	56.4	--
HUD-Owned units, end of	56992	51472	48857	35372	35154	-218	-0.6	-21838	-38.3
Single family	23180	19339	19247	20662	20348	-314	-1.5	-2832	-12.2
Multifamily	33812	32133	29610	14710	14806	96	0.7	-19006	-56.2
HUD-assigned mortgages,	233333	238624	235312	212333	189752	-22581	-10.6	-43581	-18.7
Single family	15075	19696	22948	24183	23395	-788	-3.3	8320	55.2
Multifamily	218258	218928	212364	188150	166357	-21793	-11.6	-51901	-23.8
Goverment National Mortgage Assn									
Special asstc (new commitments)									
Section 8 tandem ($)	1681.5	1500.0	1393.0	250.0	0	-250.0	-100.0	-1681.5	-100.0
Targeted tandem ($)	468.5	300.0	580.0	250.0	0	-250.0	-100.0	-468.5	-100.0
Mortgage-backed securities									
Limit on commitments	--	64000.0	68250.0	68250.0	58650.0	-9600.0	-14.1	--	--
Commitments issued in	63165.0	42150.0	36381.8	68250.0	58650.0	-9600.0	-14.1	-4515.0	-7.1
Guarantees issued in	22995.5	16852.9	13515.0	35240.0	39100.0	3860.0	11.0	16104.5	70.0
Research and technology	45.1	39.6	20.0	18.0	18.0	0	--	-27.1	-60.1
Salaries and Expenses, to	552.8	593.1	586.3	585.2	574.2	-11.0	-1.9	21.4	3.9
Transfers from FHA fun	267.0	264.0	266.8	277.7	271.1	-6.6	-2.4	4.2	1.6
Appropriation to HUD	285.9	329.1	319.5	307.5	303.1	-4.4	-1.4	17.2	6.0
Staffing (permanent/fullt	15613	15122	13828	12929	11791	-1138	-8.8	-3822	-24.5

Source: Low Income Housing Information Service (compiled from HUD Budget Documents)

TABLE 4. SUBSIDIZED HOUSING UNIT RESERVATIONS SINCE THE 1974 ACT

HUD PROGRAMS:	Actual 1975 (Net)	Actual 1976+TQ* (Net)	Actual 1977 (Net)	Actual 1978 (net)	Actual 1979 (Net)	Actual 1980 (Net)	Actual 1981 (Gross)	Actual 1982 (gross)	Proposed 1983 (gross)	Proposed 1984 (gross)
Section 8										
New construction	36798	157116	145272	99342	111692	75033	58108	24114	13600	9000
Substantial rehabilitation	--	18971	24124	22703	33346	17730	15753	3413	1000	1000
Moderate rehabilitation	--	--	--	--	34294	26167	19916	6799	--	0
Existing	55322	206046	140480	98300	90375	36336	83041	23418	67146	120340
Loan management, conversions	--	111448	21101	37172	--	13899	7213	76216	91000	74101
Subtotal, Section 8	92120	490581	330977	257517	270007	155266	176918	133406	172746	204441
Public Housing										
Conventional	36479	19252	49371	63621	449649	31834	33242	8944	0	0
Indian	2845	6888	8065	4888	5719	4893	3128	3192	2000	0
Subtotal, public housing	39324	26140	57436	68509	55368	36727	36370	12136	2000	0
Total, Section 8/public housing	131444	516721	388413	326026	325075	191993	213288	145542	174746	204441
Section 235	1138	18574	4719	11378	14471	58907	5102	4754	9000	0
Section 236	22634	11515	--	283	-85	121	-208	-688	0	0
Rent supplement	1444	-4443	--	--	--	--	-897	-38082	-73355	-65000
Section 202**	--	(29875)	(24791)	(19973)	(22525)	(18720)	(14828)	(16038)	(14000)	(10000)
HUD TOTAL	156660	542367	393132	337687	339461	251021	217285	111526	110391	139441
FARMERS HOME ADMINISTRATION										
502 home ownership loans										
New, purchase	39422	54325	39337	35663	38645	39374	39097	35901	33800	1000
Existing, purchase	16480	21447	20796	26089	24368	21558	20910	20223	19000	1000
Existing, repair or rehab	458	618	841	1013	1251	1807	1527	726	900	600
Subtotal, 502	56360	76390	60974	62765	64264	62739	61544	56850	53700	2600
515 rental or coop loans	17350	27244	30175	30446	36520	30980	28740	30500	28300	0
514/516 farm labor housing	1097	866	1208	512	2575	1490	890	748	925	388
504 very low income repair loans	2099	3115	3028	4393	5213	6934	5296	2771	6300	50
Subtotal, FmHA loans	76906	107615	95385	98116	108572	102143	96470	90869	89225	3038
504 very low inc repair grants***	--	--	1882	3183	6842	8589	7687	4205	3645	0
FMHA TOTAL	76905	107615	97627	101299	115414	110372	104157	95074	92870	3038
GRAND TOTAL	233566	649982	490399	438986	454875	375084	218182	206600	203261	142479

Notes: * TQ=Transition Quarter because of shift of fiscal year start from July to October.
** 202 units counted under Section 8
*** Some units also received 504 loans, so there is some double counting.

Source: Low Income Housing Information Service (compiled from HUD/FmHA budget documents)

TABLE 5. HUD SUBSIDIZED HOUSING STARTS AND COMPLETIONS, MAJOR HUD PROGRAMS, 1975-84

STARTS	1975 Actual	1976+TQ* Actual	1977 Actual	1978 Actual	1979 Actual	1980 Actual	1981 Actual	1982 Actual	1983 Estimate	1984 Estimate
Section 8										
New construction	--	32284	93925	139009	126853	101054	49916	71344	38000	24000
Substantial rehabilitation	--	2051	12381	19485	26398	31667	10512	16487	9000	6000
Subtotal, Section 8	--	34335	106306	158901	153251	132721	60428	87831	47000	30000
Public Housing										
Conventional	24532	17380	8115	6749	17269	36365	41660	22906	20000	11100
Indian	--	3517	3965	4581	4599	4163	3947	2194	5000	3900
Subtotal, public housing	24532	20887	12080	11330	21868	40528	45607	25100	25000	15000
Total, Section 8/public housing	24532	55222	118386	170231	175119	173249	106035	112931	72000	45000
Section 235	1801	531	3083	7382	8489	9577	38313	6096	12800	--
Section 236 and rent supplement	22070	23127	7032	1649	710	185	--	--	--	--
Section 202**	--	--	(3414)	(23372)	(23860)	(20850)	(16895)	(17253)	(14000)	(13000)
HUD TOTAL	48403	55222	128501	179262	184318	183011	144348	144348	119027	84800
COMPLETIONS										
Section 8										
New construction	--	6348	20867	46059	91304	119366	119398	77382	67600	62524
Substantial rehabilitation	--	468	4134	7685	9198	16027	22132	21437	12400	11470
Moderate rehabilitation	--	--	--	--	--	72	4896	11366	25000	20969
Existing (including conversions)	--	30922	247537	137327	107025	107288	62324	96408	148119	244486
Subtotal, Section 8	--	92015	272538	213468	207527	242753	208750	206593	253119	339449
Public Housing										
Conventional	47674	29583	4893	7457	40009	9835	29576	25051	32000	27000
Indian	--	2695	1299	2677	4363	5274	4055	3478	4000	3000
Subtotal, public housing	47674	32278	6192	10134	44372	15109	33631	28529	36000	30000
Total, Section 8/public housing	47674	124293	278730	223602	251899	257862	242381	235122	289119	369449
Section 235	2238	3498	5165	7053	13574	24136	38313	6096	12800	--
Section 236	66118	32184	13877	7204	2190	2303	--	--	--	--
Section 202**	--	--	--	(396)	(9320)	(16418)	(27968)	(24072)	(20000)	(15000)
HUD TOTAL	119215	164086	297772	237859	267663	284301	280694	241218	301919	369449

Notes: * Start of fiscal year shifted from July to October; TQ is transition quarter.
** 202 units included in Section 8 totals.

Source: Low Income Housing Information Service (compiled from HUD budget documents) operating subsidies. For this reason, we total the operating subsidies and capital costs financed through the modernization funds; the result is a proposed cut of 11% in funds available to support public housing.

TABLE 2. CHANGES IN HUD LOW INCOME HOUSING PROGRAMS, 1980-84. Table 2 shows what happened to HUD's proposals last year in the context of the 1980-84 changes.

Column (c) shows the revision of the 1982 budget proposed in January 1982: a rescission of $9.4 billion in budget authority and cessation of any expansion in subsidized housing, except for commitments made between the start of the fiscal year on October 1, 1981, and submission of the revision to Congress four months later. The budget contained a cap of 3.8 million on the number of units that could EVER be subsidized under HUD's programs.

Column (d) shows what actually happened. The Administration got less than half the rescissions it requested. Moreover, almost two thirds of the funds slated for recapture (by cancelling projects in the pipeline) were saved. Net additional units reserved were almost double the Administration's proposal. Column (e) shows the differences, in dollars, between the Administration's proposals for 1982 [column (c)] and what actually happened that year [column (d)]. Column (f) shows the change in percent [column (e) as a percent ofcolumn (c)].

A similar picture emerges for 1983, as shown in columns (g) through(j). Congress provided $11.1 billion more for low income housing than requested: appropriating $8.6 billion instead of rescinding $2.5 billion. The result is that almost 60,000 more households will get assistance than would have under the Administration budget. Moreover, the moderate rehabilitation and Indian housing programs have been kept alive. Public housing operating subsidies and modernization were both considerably increased as Congress signaled its intention to keep public housing projects for low income families, and provide the needed assistance to do it.

TABLE 3. HUD PROGRAMS OTHER THAN LOW INCOME HOUSING. Table 3 shows, again for the 1980-84 period, what happened in other HUD programs besides Section 8, Section 202, and public housing. A number of programs have disappeared entirely: the 235 home ownership program, the 312 rehabilitation loan program, the 701 planning grant program and, not shown on the table, the neighborhood self-help development and livable cities programs. For the last three years, housing counseling has also been slated to end, but has survived each time.

TABLES 4 AND 5. SUBSIDIZED HOUSING RESERVATIONS SINCE THE 1974 ACT WAS ADOPTED AND HUD SUBSIDIZED HOUSING STARTS AND COMPLETIONS. Table 4 covers both HUD and Farmers Home programs, showing reservations by program and type. These reservations are the first step in providing housing — allocating funds to specific projects or housing agencies -- and generally are made during the fiscal year for which funds were appropriated. The "starts" section of Table 5 shows the number of new or substantially rehabilitated units on which work was begun. Since the Section 8 existing and moderate rehabilitation programs do not involve "starts", these figures are much lower than either reservations or completions. "Completions" are units ready for occupancy. Because of the time it takes to produce housing (or find it, in the case of the Section 8 existing program), completions are still rising in spite of the cuts of the last two years. In fact, 1983 completions are predicted to be higher than any preceding year since 1974.

The high point for reservations was in 1976, the last year of the Ford Administration, and the only year that the national goal of 600,000 additional assisted units has ever been met.

TABLE 6. FARMER'S HOME ADMINISTRATION BUDGET DATA. The Farmers Home Administration of the U.S. Department of Agriculture is the major provider of federal housing assistance in rural areas and towns of less than 20,000.

In 1984, the Administration is proposing to substitute a rural housing block grant for all of the FmHA housing programs except grants for farm labor housing. Some funds will be available for contract amendments, but only 3038 additional units would be assisted, compared with 110,732 units in 1980.

A better picture of changes in FmHA is perhaps provided by comparing 1980 and 1983, when Congress approved far higher funding levels than requested by the Administration. Nevertheless, the number of assisted units has dropped by 16% since 1980, while the number of unsubsidized loans or loan guarantees has dropped by almost 100%.

Columns (a) through (c) show actual dollar and program levels for 1980-1982. Column (d) is the 1983 appropriation and estimated number of units. Columns (e) and (f) compares the 1983 levels with 1980. Columns (g) through (k) deal with the 1984 proposed budget, comparing it with both 1980 and 1983 levels.

The dollar levels for loans represent amounts actually lent, not the cost to the government of these programs. The subsidized loans are at low interest rates -- down to 1%.

The lines for reimbursements to the Rural Housing Insurance Fund and Rural Development Insurance Fund show the cost to the federal government of the interest payments (and losses, when they occur) for the FmHA programs. The reimbursements cover costs in prior years that have not previously been reimbursed and there is generally a two-year lag.

TABLE 7. REVENUE LOSSES FROM TAX EXPENDITURES, 1980-84. Table 7, drawn from a Special Analysis by the Treasury Department, shows the revenue losses resulting from housing-related provisions of the Internal Revenue Code. The bulk of these are home owner deductions for mortgage interest and property taxes, which will have increased by 64% if the estimates are right. Indeed, the $3.7 billion increase from 1983 to 1984 is almost five times the increase in housing payments which will result from occupancy in 1984 of units approved in previous years.

The total cost of housing related tax subsidies in 1984 is estimated at over $40 billion -- far more than the highest appropriation ever made for low income housing.

In its analysis, the Treasury Department states: The definition of tax expenditures is based on the distinction between the 'normal' or 'reference' provisions of the tax structure needed to make the tax operational and the 'special' provisions that are exceptions to the reference tax provisions. Such exceptions are designed to further other objectives, such as health care, export promotion or employment of the handicapped. Their operation is, therefore, comparable to outlay programs, such as milk price supports and rent subsidies that also provide a subsidy to particular activities. For this reason, the expressions 'tax subsidies' and 'tax expenditures' are often used synonymously. Because the term 'tax subsidies' is somewhat more descriptive than 'tax expenditures', the former will be used in the remainder of this analysis. ("Special Analysis G: Tax Expenditures", Special Analyses: Budget of the United States Government, Fiscal Year 1984, p. G-1.)

TABLE 5.

TABLE 6. FARMERS HOME ADMINISTRATION BUDGET DATA (DOLLARS IN MILLIONS)

Program		(a) 1980 Actual	(b) 1981 Actual	(c) 1982 Actual	(d) 1983 Estimate	(e) Change 1980-83 Amount	(f) 1980-83 %	(g) 1984 Estimate	(h) Change Amount	(i) 1983-84 Percent	(j) Change Amount	(k) 1980-84 Percent
SUBSIDIZED LOANS												
502 Home ownership,new	$	1392.4	1462.1	1419.0	1415.0	22.6	1.6	60.0	-1355.0	-95.8	-1332.4	-95.7
Existing	$	783.1	812.5	850.6	850.0	66.9	8.5	195.0	-655.0	-77.1	-588.1	-75.1
Repair/rehab	$	44.6	53.0	30.4	35.0	-9.6	-21.5	25.0	-10.0	-28.6	-19.6	-43.9
Subtotal	$	2220.1	2327.6	2300.0	2300.0	79.9	3.6	280.0	-2020.0	-87.8	-1940.1	-87.4
504 repair loans	$	21.9	17.9	10.0	24.0	2.1	9.6	1.0	-23.0	-95.8	-20.9	-95.4
515 rental housing loans	$	825.3	842.5	953.7	940.0	114.7	13.9	16.0	-924.0	-98.3	-809.3	-98.1
514 farm labor hsg loans	$	24.6	18.5	11.9	19.0	-5.6	-22.8	3.0	-16.0	-84.2	-21.6	-87.8
Subtotal. subsidized	$	3091.9	3206.4	3275.6	3283.0	191.1	6.2	300.0	-2983.0	-90.9	-2791.9	-90.3
UNSUBSIDIZED LOANS												
502 low income	$	30.9	4.7	2.8	0	-30.9	-100.0	0	0	0	-30.9	-100.0
502 moderate income	$	573.5	251.3	173.8	28.0	-545.5	-95.1	0	-28.0	-100.0	-573.5	-100.0
502 REA weatherization	$	1.3	1.7	1.8	1.0	-0.3	-23.1	0	-1.0	-100.0	-1.3	-100.0
502 Above-mod guaranteed	$	18.9	5.7	0	0	-18.9	-100.0	0	0	0	-18.9	-100.0
Rural housing site loans	$	0.8	5.7	0	2.0	1.2	150.0	0	-2.0	-100.0	-0.8	-100.0
Total unsubsidized	$	625.4	263.9	178.2	31.0	-594.4	-95.0	0	-31.0	-100.0	-625.4	-100.0
TOTAL LOANS	$	3773.3	3470.3	3453.8	3314.0	-459.3	-12.2	300.0	-3014.0	-90.9	-3473.3	-92.0
REIMBURSEMENT TO RURAL HOUSING INSURANCE FUND	$	2280.2	594.0	2003.5	1627.8	-352.4	-15.5	1508.1	-119.7	-7.4	-772.1	-33.9
GRANTS AND PAYMENTS												
Rural rental assistance	$	393.0	403.0	398.0	124.0	-269.0	-68.4	62.0	-62.0	-50.0	-331.0	-84.2
504 home repairs	$	24.0	25.0	15.0	12.5	-11.5	-47.9	0	-12.5	-100.0	-24.0	-100.0
Farm labor housing	$	25.0	25.0	13.8	0	-25.0	-100.0	4.4	4.4	--	-20.6	-82.4
Mutual and self-help hsg	$	5.0	0	4.0	12.5	-7.5	-150.0	0	-12.5	-100.0	-5.0	-100.0
Self-help land devel	$	0	1.0	0	0	0	0	0	0	0	0	--
Supervisory assistance	$	1.5	1.0	0	0	-1.5	-100.0	0	0	0	-1.5	-100.0
Water & waste disposal	$	290.0	210.0	125.0	125.0	-165.0	-56.9	90.0	-35.0	-28.0	-200.0	-69.0
Rural development	$	10.0	5.0	0	0	-10.0	-100.0	0	0	0	-10.0	-100.0
Construction defect comp	$	--	--	--	2.0	2.0	--	0	-2.0	-100.0	0	--
Rural community fire prot	$	3.5	3.5	3.3	3.3	-0.3	-8.6	0	-3.3	-101.5	-3.5	-100.0
Rural housing block grant	$	--	--	--	--	--	--	850.0	850.0	--	850.0	--
Subtotal	$	748.5	670.0	555.7	274.0	-474.5	-63.4	156.4	-117.6	-42.9	-592.1	-79.1
Salaries and expenses	$	235.6	252.6	279.6	299.0	63.4	26.9	318.5	19.4	6.5	82.9	35.2
Total	$	984.1	922.6	835.3	573.0	-411.1	-41.8	474.8	-98.2	-17.1	-509.3	-51.0
RURAL DEVELOPMENT LOANS												
Water & Waste Disposal	$	700.0	750.0	375.0	375.0	-325.0	-46.4	250.0	-125.0	-33.3	-450.0	-64.3
Community facilities	$	240.0	260.0	126.2	130.0	-110.0	-45.8	100.0	-30.0	-23.1	-140.0	-58.3
Industrial development	$	1073.8	652.3	61.2	300.0	-773.8	-72.1	0	-300.0	-100.0	-1073.8	-100.0
Alcohol production	$	--	--	63.9	0	--	--	0	0	0	0	--
Total	$	2013.8	1662.3	626.3	805.0	-1208.8	-60.0	350.0	-455.0	-56.5	-1663.8	-82.6
REIMBURSEMENT TO RURAL DEVEL. INSURANCE FUND	$	91.9	217.4	180.0	347.3	255.4	278.0	477.8	130.5	37.6	386.0	420.1
UNITS ASSISTED												
502 new l.i. ownership	U	39374	33097	35901	33800	-5574	-14.2	1000	-32800	-97.0	-38374	-97.5
Existing	U	21558	20910	20223	19000	-2558	-11.9	1000	-18000	-94.7	-20558	-95.4
Rehab	U	1807	1527	726	900	-907	-50.2	600	-300	-33.3	-1207	-66.8
Subtotal	U	62739	61534	56850	53700	-9039	-14.4	2600	-51100	-95.2	-60139	-95.9
504 repair loans	U	6934	5296	2771	6300	-634	-9.1	50	-6250	-99.2	-6884	-99.3
504 repair grants	U	8589	7687	4205	3645	-4944	-57.6	0	-3645	-100.0	-8589	-100.0
515 rental housing	U	30980	28740	30500	28300	-2680	-8.7	0	-28300	-100.0	-30980	-100.0
514 farm labor housing	U	1490	890	748	925	-565	-37.9	388	-537	-58.1	-1102	-74.0
Rural rental assistance (	U	20000	17655	14280	11750	-8250	-41.3	0	-11750	-100.0	-20000	-100.0
Subtotal. subsidized	U	110732	104147	95074	92870	-17862	-16.1	3038	-86747	-92.8	-104049	-94.0
502 moderate or low incom	U	17543	7990	5107	745	-16798	-95.8	0	-745	-100.0	-17543	-100.0
502 guaranteed loans	U	590	172	0	0	-590	-100.0	0	0	0	-590	-100.0
Subtotal, unsubsidized	U	21628	8922	5107	745	-20883	-96.6	0	-745	-100.0	-21628	-100.0
Total housing program	U	132360	113069	100101	93615	-38745	-29.3	3038	-90577	-96.8	-129322	-97.7

Source: Low Income Housing Information Service (based on data in Appendix: Budget of U.S. Govt, 1982-84)

TABLE 7. REVENUE LOSSES FROM HOUSING-RELATED TAX EXPENDITURES

REVENUE LOSSES FROM TAX EXPENDITURES, 1982-84
(In millions of dollars)

Description	1980	1981	FY 1982	FY 1983	FY 1984	Change 1983-84	% Change	Change 1980-84	% Chng 1980-84
Mortgage interest deductions	15615	20145	23305	25065	27945	2860	11.5	12330	79.0
Property tax deductions	7310	9125	8360	8765	9535	770	8.8	2225	30.4
Subtotal	22925	29270	31665	33830	37480	3650	10.8	14555	63.5
Capital gains deferral	1010	1160	1625	1480	1740	260	17.6	730	72.3
Capital gains exclusion	535	450	585	535	630	95	17.8	95	17.8
Residential energy credits									
Supply incentives	--	--	250	430	575	145	33.7	575	--
Conservation incentives	--	--	220	125	25	-100	-80.0	--	--
Subtotal	485	575	470	555	600	45	8.1	115	23.7
Tax exempt bonds									
Owner-occupied units	--	--	905	1110	1290	180	16.2	--	--
Rental housing	--	--	395	530	710	180	34.0	--	--
Subtotal	447	1120	1300	1640	2000	360	22.0	1553	347.4
Five-year rehab amortization	15	30	45	55	65	10	18.2	50	333.3
Expensing of interest, etc	659	755	--	--	--	--	--	-659	-100.0
Excess depreciation	385	--	--	--	--	--	--	-385	-100.0
"All Savers" certificates	0	0	935	1665	320	-1345	-80.8	320	--
Subtotal	1059	755	980	1720	385	-1335	-77.6	-674	-63.6
TOTAL	26461	33330	36625	39760	42835	3075	7.7	16374	61.9

Source: Low Income Housing Information Service

GLOSSARY

Note: This glossary attempts a brief explanation of the terms used in this memo. We have deliberately omitted lots of detail to try to keep it short. If there are other terms you'd like defined, drop us a line. We'll try to improve and update this from time to time.

202 - See Section 202.
236 - See Rental Housing Assistance
502 - See Home Ownership Assistance
504 - See Home Repair Loans and Grants
514 - See Farm Labor Housing
515 - See Rental Housing Assistance
516 - See Farm Labor Housing

ANNUAL CONTRIBUTION CONTRACT (ACC). The contract between HUD and a local housing authority covering principal and interest on bonds used to finance public housing.

APPROPRIATION. An act of Congress approving spending of specified amounts of money for particular departments and programs. HUD programs are included in the HUD-Independent Agencies Appropriation; Farmers Home programs, in the Agriculture Appropriation.

AUTHORIZATION. Legislation which establishes or continues a federal program or agency. Normally, housing programs are authorized each year, for the fiscal year ending September 30. Thus, they must be reauthorized each year before funds can be appropriated.

BUDGET AUTHORITY (BA). The basic way of measuring federal spending. Budget authority is the authority to spend money, now or in the future. Low income housing budget authority is calculated by multiplying the contract authority by the number of years in the contract.

BUDGET RESOLUTION. A joint resolution of the Congress, not subject to veto by the President, which sets overall budget totals (receipts, spending, and the size of the deficit) as well as ceilings on each major function, subfunction and program. The ceilings themselves, except for major functions, do not appear in the budget resolution, but allocations are made to each committee based on the assumptions in the totals. Committees may shift funds around within their allocations, but in recent years it has proven almost impossible to breach the overall ceilings.

CARRYOVER. Funds not spent in one year which can be used in the next.

CDBG (COMMUNITY DEVELOPMENT BLOCK GRANTS). A HUD program of grants for local community development activities. Grants must be used for benefit of low and moderate income people, to prevent or eliminate slums and blight, or for other urgent community needs, principally to benefit lower income people. Funds are distributed by formula to entitlement communities (cities of 50,000 or more and urban counties) and to states. Nonentitlement communities apply to states (called the States Program), where they administer the program, or directly to HUD.

CONSTANT DOLLARS. Dollar figures adjusted for inflation. Currently, the base year used is 1972. There are various ways of making the adjustments. OMB uses the "GNP deflator" or adjustment of the gross national product to determine constant dollar budget figures. LIHIS has used it in this memo.
CONTRACT AUTHORITY (CA). Authority to make contracts. In low income housing, contract authority is the maximum amount of the annual spending for the housing assistance provided.

CONVERSION. Changing from one program or use to another. In HUD programs, conversions usually refer to shifting the subsidy contract from one program to another (e.g. from rent supplements to Section 8). Elsewhere, it frequently refers either to changing units or buildings from rentals to cooperatives or condominiums or to changing the number of units in a structure.
CURRENT DOLLARS. Not adjusted for inflation. Therefore, year-to-year comparisons are misleading.

DEFERRAL. Postponing spending until some future time. Deferrals may be disapproved by either house of Congress, in which case the money must be spent as appropriated.

ELDERLY HOUSING. See Section 202.

EXISTING HOUSING. See Section 8.

FAIR MARKET RENT (FMR). The standard used to measure rents (and therefore subsidies under Section 8). Theoretically, it is what comparable units rent for in the private market. HUD publishes separate FMR's, by area and unit size, for new (or substantially rehabilitated) units and for existing units.

FARMERS HOME ADMINISTRATION (FmHA). The agency in the Department of Agriculture which administers rural housing programs.

FARM LABOR HOUSING. A FmHA program of low interest loans and grants for construction of housing for migrant farmworkers.

FLOOR ACTION. Refers to debate and passage of a bill, resolution, or appropriation "on the floor" of the House or Senate.

HEARING. Taking of testimony. In Congress, this is separate from "mark-ups" or actual decision-making on legislation. In addition to statements by witnesses, most hearings include written statements and communications sent in by those wishing to express their views.

HOME OWNERSHIP ASSISTANCE. A FmHA program of low-interest loans (down to 1%) for purchase of new or existing housing in small towns or rural areas.

HOME REPAIR LOANS AND GRANTS. A FmHA program of loans, grants, or a combination of the two to enable rural home owners to eliminate major housing deficiencies. Grants may be made only to elderly owners. The program is limited to very low income owners.

HOUSING ASSISTANCE PAYMENT/HOUSING ALLOWANCE/HOUSING PAYMENT CERTIFICATE. See "voucher".

HOUSING PAYMENTS. In the HUD budget, refers to payments under all low and moderate income subsidy contracts (except for public housing operating subsidies). As the number of assisted units increases, the amount of payments rises.
HUD-HELD OR HUD-OWNED PROPERTIES. HUD insured properties where the mortgages are so delinquent that they have been assigned to HUD (known as HUD-held) or been foreclosed (HUD-owned).

LOAN MANAGEMENT. A program of using Section 8 subsidies to provide additional assistance to housing projects assisted under other programs which are (or were) in financial difficulty.

LOWER INCOME. Used in federal law to refer to households with incomes below 80% of median, generally the bottom 40% of the income distribution.

MARK-UP. Action on a bill or proposal by a Congressional Committee. So-called because committee members use or, literally, mark up a draft or proposal.

MODERATE REHABILITATION. See Section 8.

NEGATIVE RENTS. When tenants in subsidized housing pay their own utilities, the utility cost may be greater than the tenant contribution. In this case, the tenant gets a check to pay the excess utility costs. These are called "negative rents" since the landlord pays the tenant. It is important to remember, however, that the tenant contribution is theoretically the same, whether it is paid to the landlord or the utility companies. In fact, tenant utility payments often exceed the allowance, so rents (which, by law, include utilities) may be higher for tenants with negative rents than for others with the same incomes whose utilities are paid by the owner.

NEW CONSTRUCTION. See Section 8.

OMB. The OFFICE OF MANAGEMENT AND BUDGET, part of the White House, which effectively oversees much of the operation of the federal government.

OUTLAYS (O). Checks issued or cash disbursed. When the government actually pays, that's an outlay. Low income housing outlays (housing payments) cover ALL of the contracts currently in force, some of them dating back to the 1930's.

PIPELINE. Refers to housing for which funds have been appropriated but which is not yet occupied and applies primarily to new construction or substantial rehabilitation. Each year, after the appropriation is set, HUD allocates funds to its regions and area offices according to a "fair share" formula (which must be approved by OMB). Section 8 Existing funds move through the pipeline quickly but it often takes several years for new or rehabbed projects. Major stages in the pipeline are "reservations", "starts", and "completions".

PROPERTY DISPOSITION. Refers to sales of HUD-owned or HUD-held properties, often with Section 8 assistance to make it possible for lower income people to live in them.

PUBLIC HOUSING. Sometimes incorrectly used as a synonym for any subsidized low income housing. Public housing is a program established in 1937 under which local housing authorities operate housing for low income people. With few exceptions, the housing is owned by the authority. The federal subsidy covers interest and amortization on the bonds financing the units. In addition, because rental income no longer covers operating costs, as it did during the early years of the program, separate operating subsidies are provided.

PUBLIC HOUSING MODERNIZATION. A program to provide major improvements, particularly energy conservation retrofitting, for older public housing projects. Modernization may not be used for deferred maintenance, and is regarded as a capital improvement. The BA is for annual contributions covering interest and principal for 20-year bonds.

PUBLIC HOUSING OPERATING SUBSIDIES. Payments for the operation of public housing. These are handled separately from the annual contributions which cover amortization of the debt for building or modernizing public housing.

RECAPTURES. Funds which had been obligated for a project which has been cancelled and which therefore can be re-used. HUD is proposing to finance a large part of its current program out of such recaptures, generally switching funds from new construction or substantial rehabilitation to existing units.

RENTAL HOUSING ASSISTANCE. A general term for housing assistance provided under a number of programs, known mostly by their section numbers. SECTION 236 (of the National Housing Act), enacted in 1968, lowers the effective interest rate down to 1% for nonprofit and limited dividend providers of rental housing. The lower interest rate, however, does not provide enough subsidy to make 236 affordable for very low income families and so various methods have been used to supplement this subsidy, including rent supplements and, in recent years, Section 8. SECTION 221(d)3 was a below-market-interest predecessor of 236, also confined to nonprofits and limited dividend corporations. SECTION 515 (of the Housing Act of 1949) is a Farmers Home program which provides as low as 1% loans for rental housing in rural areas; 515 may be used by nonprofits, for-profits, or public agencies. It has been coupled with Section 8 to serve very low income families and there also a small RURAL RENTAL ASSISTANCE program to cover operating costs for 515 projects so they can serve very poor people.

RENT SUPPLEMENTS. A HUD program enacted in 1965 under which HUD pays to the owner (nonprofit or limited dividend) the difference between the tenant rent and the economic rent of the unit. Rent supplement projects were built under 40-year contracts which are now being converted to 15-year Section 8 existing contracts. The budget authority thus saved is being rescinded. Between 1968 and 1974, rent supplements were often combined with 236.

REPROGRAMMING. More or less the same as recaptures, except that the shift is made before funds are obligated, so that the shift is made internally from one program to another. Much of HUD's housing activities are to be financed with such reprogrammed funds.

RESCISSION. Repeal or cancellation of an appropriation already made. Rescissions must be approved by both houses of Congress.

RESERVATION. A specific allocation of funds to support a particular contract to provide housing assistance. Generally, this is regarded as a firm commitment by HUD to fund a project or group of Section 8 existing certificates. GROSS RESERVATIONS refer to the total number of reservations made, prior to any cancellations. NET RESERVATIONS are gross reservations minus cancellations. HUD starting using gross, rather than net, reservation figures in 1982.

RURAL HOUSING INSURANCE FUND. A revolving fund used for FmHA rural housing programs. The fund is reimbursed annually for cost of interest subsidies and losses. A similar fund, the RURAL DEVELOPMENT INSURANCE FUND, finances FmHA rural development programs.

SECTION 8. The basic HUD subsidized housing program since 1974, contained in Section 8 of the U.S. Public Housing Act of 1937 as revised. Despite its location and the fact that the authorization for both public housing and Section 8 is contained in Section 5(c) of the act, Section 8 is usually considered a separate program. The concept behind Section 8 was to provide a single subsidy to cover the difference between the cost of the unit and the amount the tenant paid. Thus, Section 8 assistance covers both the cost of providing the unit in the first place (amortization of the mortgage or loan) and the cost of operations (utilities, maintenance, taxes, etc).

There are four more or less separate Section 8 subprograms:

SECTION 8 EXISTING uses the present stock of housing. Generally, certificates are provided to recipient households, who then find their own units, which must meet basic housing quality standards and may not (with certain exceptions) exceed local fair market rents. The Section 8 Existing program is administered by local housing agencies, generally housing authorities. In addition, some Section 8 Existing funds are used to provide assistance to specific projects, usually those already built under older programs and needing additional help to cover operating costs. The units now subsidized under the obsolete Section 23 and Rent Supplement programs are being converted to Section 8.

SECTION 8 MODERATE REHABILITATION. A variation of the Section 8 existing program under which communities receive Section 8 funds to permit lower income households to live in units which have been brought up to decent standards without first being gutted.

SECTION 8 NEW CONSTRUCTION. Self-evident. Section 8 developments may be built by public agencies, nonprofits, cooperatives, limited dividend corporations or private, for-profit investors. Budget authority for Section 8 new is the annual contract for the subsidy (including taxes, utilities and maintenance) multiplied by the 20-year term. Thus, the total cost appears very high; so does the annual cost, since it contains an allowance for future inflation (by assuming that there will be no rental income).

SECTION 8 SUBSTANTIAL REHABILITATION. Refers to units which are generally gutted and rebuilt. Thus the cost (and fair market rents) are comparable to those for new construction.

SECTION 23. A program, similar to Section 8 but preceding it, in which public housing funds were used to assist tenants renting private accommodations. Superseded by Section 8 in 1974, and Section 23 units are gradually being converted to Section 8.

SECTION 202 HOUSING FOR ELDERLY AND HANDICAPPED. Enacted in 1965 as a direct loan program (at 3% or less) to provide housing through nonprofit organizations for elderly and handicapped people, the program was revised in 1974. Now, it provides financing, and is coupled with Section 8 assistance to make the units affordable. Generally, 10% of the units are for nonelderly handicapped; the rest, for elderly.

START. The beginning of construction or major rehabilitation on a housing development. (See "pipeline".)

TAX EXPENDITURES OR TAX SUBSIDIES. Terms used by the U.S. Treasury (and others) to refer to "Provisions of the Federal income tax laws that allow a special exclusion, exemption, or deduction from gross income or provide a special credit, preferential rate of tax, or deferral of tax liability. Tax expenditures frequently have results similar to spending programs, loan guarantees, or regulations." (The U.S. Budget in Brief: Fiscal Year 1984.)

TENANT CONTRIBUTION. The tenant payment toward rent (and utilities) in subsidized housing. Currently, the tenant contribution is set at 30% of income for all "new" tenants (with some deductions and exclusions permitted, but these may be changed). Tenants as of October 1981 are having their rents increased from 25% to 30% over a 5-year phase-in period.

UDAG (URBAN DEVELOPMENT ACTION GRANT). A competitive program under which grants are made to distressed communities (or for distressed neighborhoods), now primarily for economic development and job creation. Formerly also used for neighborhood revitalization.

VERY LOW INCOME. Used in federal law to refer to households whose income is below 50% of the median. Generally, this is the bottom quarter of the income distribution.

VOUCHERS. Generally used to describe housing subsidies which cover the difference between tenant contributions and the rent, including utilities, of the unit occupied. Section 8 Existing, Section 23, and housing allowances are all forms of "voucher" programs. The term is often used to describe the emphasis by HUD and the Reagan Administration on using the existing housing stock, although neither HUD nor the Administration itself uses the word. The present HUD term is "Housing Payment Certificate" or HPC.

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Mrs. Roisman.

STATEMENT OF FLORENCE ROISMAN, NATIONAL HOUSING LAW PROJECT

Ms. ROISMAN. Thank you, Mr. Chairman. We very much appreciate the invitation to testify and the courtesy and attention that minority staff and majority staff have accorded to us. Since my full statement will be printed——

Senator TOWER. We will incorporate your full statement in the record and you may summarize.

[The complete statement follows:]

STATEMENT
OF
THE NATIONAL HOUSING LAW PROJECT

The National Housing Law Project appreciates the opportunity to present to the Subcommittee our views on low-income housing issues related to this year's housing legislation. Our views are that (1) the public housing model lease and grievance procedure should be preserved; (2) demolition and other dispositions of public housing should be restrained; (3) HUD's policies which threaten loss of the subsidized stock must be changed; (4) Section 8 fair market rents should not be set at the 40th percentile of all existing units; (5) tenants' rents should be maintained at 25 percent of adjusted income; (6) food stamps should not be treated as income; (7) housing subsidies should not be treated as income; (8) rent increases experienced by elderly Rent Supplement tenants who are converted to Section 8 should be capped at 10 percent annually; (9) adequate funds should be authorized for public housing new construction, Section 8 existing (rather than vouchers), public housing operating subsidies, public housing modernization and flexible subsidies; and (10) federal controls are needed to ensure that the CDBG program benefits poor people.

I. PUBLIC HOUSING MODEL LEASE AND GRIEVANCE PROCEDURES

The Department of Housing and Urban Development (HUD) is proposing to repeal the current regulations (24 C.F.R. Part 866) that establish model lease and grievance procedures for public housing. Those regulatory requirements were initially developed in 1971, after extensive negotiations with representatives of the housing authorities (NAHRO) and tenants (NTO). They grew out of dissatisfaction with the practices of some, but not all, public housing authorities (PHAs) and PHA employees, that caused unfairness in the leasing and operation of PHA projects. They reflected judicial decisions regarding the minimum level of fairness required of government agencies that are landlords. They were designed to provide a realistic means for quickly and fairly resolving disputes between tenants and PHAs, before the problems fester and hostilities develop. HUD's power to issue the regulations and the reasonableness of its judgment in doing so were sustained in court after court. The regulations themselves were readopted in 1975, after an extensive two-year review by new HUD officials with widespread input from PHAs, tenants and other members of the public.

These carefully developed requirements should not be lightly thrown aside under the banner of "deregulation." Our experience and the experience of thousands of Legal Services attorneys demonstrate that public housing tenants cannot get a full and fair hearing in state eviction courts. To prepare our comments upon HUD's proposed repeal, we surveyed attorneys in all 50 states, the District of Columbia and Puerto Rico. Even we were surprised at deficiencies that remain, especially in practice, in the state court eviction process. In summary, we found:

- Self-help eviction tactics, such as lockouts and utility shutoffs are still permitted in 11 states.

- In at least one state, Arkansas, landlords can use a criminal proceeding to force tenants out. (We know of at least one Section 8 tenant who was jailed when she withheld rent because of a dispute with her landlord over a leaky shower.)

- Four states authorize court clerks or judges to immediately award possession to the landlord without a full hearing on the merits while the eviction action is still pending.

- In 17 states, the landlord may go straight to court without providing the tenant any prior notice of alleged nonpayment or other breach of the lease.

- In 10 states, the time between service of the complaint and the trial is five days or less, making preparation almost impossible. In the majority of the states the trials are held within 15 days of service of the complaint.

- Given the short time periods between service and trial, it is the rare tenant who can find out, through discovery, the alleged facts of the case against him and be prepared at trial to meet them. In fact, 21 states severely restrict or prohibit discovery in eviction cases.

- In many states eviction actions are tried by justices of the peace or magistrates without any legal training, much less an understanding of the federal housing programs.

- In large urban areas, the calendars are so crowded and evictions handled so rapidly, that the tenants barely know what is happening and the judges never approach the real facts and the relevant legal arguments in individual cases. For example, a 1978 study found that in Chicago "the average amount of time devoted by the judge to a contested eviction is approximately _two minutes_." _See_ _Judgment Landlord: A Study of Eviction Court in Chicago_, pp. 9-10 (1978).

The details of our survey are reported in our Comments to HUD, a copy of which we can make available to the Committee.

In contrast with these glaring deficiencies in the state court eviction proceedings, the grievance procedures have great value for both the PHA and the tenants in resolving eviction issues and other disputes. They save costs, especially court costs. They provide a mechanism for correcting tenant behavioral problems. They create a "cooling off" period which, in and of itself, resolves many problems. They enable both the PHA and the tenant to discover information about the other's case so that each can evaluate his or her position realistically. They allow quick resolution of disputes and enable PHAs to work out rent collection agreements short of expensive litigation. By quickly resolving questions, they avoid unnecessary hostilities and enable good managers to become aware of problems and solve them before they get out of hand.

The present minimum requirements regarding the leases should also be retained. They provide for the public housing program what is required by statute in both the Section 8 and FHA-subsidized programs, namely that tenants should not be evicted without good cause. Compare 42 U.S.C. §1437f(d)(1)(B) and 12 U.S.C. §1715z-1b. They prohibit PHAs from using unfair clauses, such as clauses waiving the tenants rights to legal notices and to be heard in court. They implement the basic principle that PHAs must provide housing that is decent, safe and sanitary, an obligation which the courts have found is unenforceable, except by an action to enforce the lease. See, e.g., Perry v. Housing Authority, 664 F.2d 1210 (4th Cir. 1981). HUD should not be free to irresponsibly discard all of these basic requirements. Thus, we have attached to this statement proposed statutory language and legislative history to preserve the public housing model lease and grievance procedure (Attachment A).

II. PUBLIC HOUSING DEMOLITION AND DISPOSITION

Public housing is the federal housing program which most often serves the very poorest families in this county. The public housing stock is the most valuable resource for these families. Yet thousands of public housing units around the country are being lost, many because of deliberate decisions to close them down, demolish them or sell them. Last year in its budget HUD comtemplated the closing of 5,000 occupied units of public housing and this year it contemplates the same. See U.S. Department of HUD, FY 1984 Budget, Summary, January 1983, p. H-2. We are aware, from calls from numerous legal services attorneys and other sources, of numerous instances in different cities in which PHAs have proposed to sell or demolish public housing projects or have actually done so. On a policy level, there have been numerous proposals by HUD officials, in addition to the recommendations of the President's Commission on Housing which reveal plans to close down public housing projects, because they are too expensive to operate, they are located in undesirable neighborhoods, they are located in desirable neighborhoods or they are too deteriorated.

In light of the clear threat from this administration, as well as some local governments, there is a need for strong legislation to prevent the demolition or other disposition of public housing units. The public housing statute should provide that public housing units may not be demolished or disposed of if there is a need for low-income units in the community, provided, however, that which can be replaced more cheaply by new construction than rehabilitation may be disposed of or demolished if they are in fact replaced. Standards should be provided for approving a disposition or demolition plan once it is determined that the costs of rehabilitation are excessive despite the need for low-income housing in the community.

The existing statutory provisions are not explicit enough. 42 U.S.C. §1437d(f). To rectify that problem, the public housing statute must be amended to provide that disposition and demolition of public housing units shall be permitted only if:

- It is determined that the units are in excess of the local need for low-income housing; or
- It is cheaper to replace the units by new construction than by rehabilitation and the units are in fact replaced.

In the event that there is a need for low-income housing but the rehabilitation costs are in excess of new construction costs, the statute should provide that disposition or demolition may occur only if:

- HUD approves;

- Units are replaced upon a one-for-one basis within the community;

- Full relocation benefits, including the right to move into a replacement unit, are awarded to all displacees; and

- Tenants residing in the units and local tenant councils have been given a 12-month notice of the proposed action, are fully involved in the decision-making process, and concur in the final plan for disposition or demolition.

Finally, the Secretary should be authorized to recapture any contract authority that may be made available as a result of the demolition or disposition and required to apply such recaptured authority to the construction or acquisition of new public housing units.

The housing legislation reported by this Committee last year (S. 2607) contained a provision directed at this problem. See §205, p. 51. However, it needs to be improved for a number of reasons. First it is phrased as an authorization to HUD to provide PHAs financial assistance for the demolition or sale of projects, instead of being a prohibition or restraint on such activities. Thus, it would appear to be an invitation to further demolition and sales, instead of a deterrent. In addition, those restraints which do arise out of the conditions the section places upon the availability of financial assistance would not apply if the PHA decided to demolish or sell a project without HUD assistance, which is possible, especially with projects in desirable locations.

Second, the section would allow sale of a project if there are other properties which are more efficient or effective to operate as a lower-income housing project. §17(b)(1). That standard opens the door to abuse without adequate safeguards to ensure that each unit sold is replaced on a one-for-one basis and that the money for the replacement is committed at the time of sale and is not money that would have been available even in the absence of the sale. The further standard which allows a sale when the Secretary determines it would be in the best interest of the tenants and the PHA (§17(b)(1)), again would invite this Administration to convert public housing families to the voucher program and then sell their units.

Third, the section only requires the PHAs to "consult" families to be displaced by the demolition when it formulates its plans. The section should also require participation of other tenants in the PHAs projects, because they will be affected by the closing of a project, in terms of their transfer rights, if nothing else. More importantly, the views of applicants and potential applications must be heard, because they are strongly affected when the limited supply of public housing is made even more limited by the closing of a project. In addition, with regard to all these individuals, the PHA should not only consult them; it should be required to obtain their agreement or at least to give their views serious consideration. Compare 12 U.S.C. §1715z-1b(b)(1).

Fourth, the protections for displaced families established by the section are insufficient. See §17(c)(3). They provide only assistance under Section 8 or replacement housing in a low-income housing project, including assistance in locating a unit. Any one being displaced should have a right of first refusal in any replacement housing units. Tenants who are most adversely affected by the closing should not be denied the benefits of the closing as well. If either §8 or public housing are used to rehouse the displaced families, they must be assured that their new homes will be decent, safe and sanitary and located in neighborhoods which are not less desirable with respect to their job locations, their social services needs and living conditions generally. And, finally, when Section 8 is used, there must not be merely assistance in locating a unit. There must be a guarantee of an actual unit under the program.

III. HUD'S POLICIES CONCERNING TROUBLED SUBSIDIZED PROJECTS FORECLOSURE AND PROPERTY DISPOSITION

Since new low-income housing production is virtually at a standstill, the existing stock of HUD subsidized privately owned housing is becoming an increasingly important national resource. HUD has taken several actions, and proposes to take several more, that would deplete the existing supply of subsidized units, rather than enhance the prospects of continued use for low-income people. These actions have occurred at many points along the life of any particular project, but the following will focus on HUD's lack of a clear policy on Section 202 prepayments, HUD's policy of moving faster on defaults on HUD-held mortgages, HUD's policy concerning sales of troubled projects to new owners, HUD's policy concerning continued use restrictions for projects purchased by other bidders at foreclosure sale, problems arising during the period of HUD ownership and management after foreclosure, and HUD's property disposition policies. We will briefly examine each of these in turn.

Section 202 Prepayments

HUD still has no clear policy on when it will allow nonprofit owners to prepay the loans that HUD holds on Section 202 projects. In March of 1982, in an unprecedented move, HUD allowed one nonprofit owner in Pasadena, California, to prepay the loan on a 150-unit elderly housing project 34 years prior to its 50-year maturity date. HUD thought that extracting a promise from the owner to provide life tenancies to existing residents was an adequate protection for the interests of the federal government. Were it not for a lawsuit brought by the tenants, Gordon v. Pierce, No. 82-4362-RMT (Mcx) (C.D. Cal., filed Aug. 25, 1982), these 150 units providing high-quality housing for elderly citizens would have been lost to needy persons in the future. HUD still has no coherent policy on when and under what conditions the agency will accept prepayment requests. HUD's Assistant Secretary Phillip Abrams, who approved the prepayment of the Pasadena project, stated in 1982, in testimony before the Senate Housing and Urban Affairs Subcommittee, that HUD will evaluate prepayment requests on a "case-by-case basis," considering such factors as the interests of the tenants, the interests of the government (presumably, only its financial interest, without regard to its congressionally established duties), the term of the mortgage, and so forth.

Jeopardized by HUD's ad hoc approach is a total stock of approximately 170,000 units of Section 202 housing nationwide, representing total federal loan commitments in excess of $3 billion. Since that money was loaned for a definite purpose -- to finance low-cost rental housing for elderly and handicapped families -- and the program has proven to be effective in efficiently accomplishing that purpose, we believe that prepayments are contrary to the intent of Congress in establishing the program. These affordable units must be preserved for their intended use wherever possible.

HUD-held Mortgage Delinquencies

In June of 1982, HUD adopted a new policy, "cracking down" on mortgage delinquencies of assigned projects. In this policy, HUD stated that all delinquent loans must be under an approved plan to bring them current (almost always within 24 months) by September 30, 1982, or foreclosure would be commenced. Projects with large delinquencies therefore face almost certain sale or foreclosure, even if the delinquency is an old one and the project has made progress toward reducing its size in recent years. The net result of this policy is that many projects will be taken out of the nonprofit and cooperative sector and transferred to private ownership, which in some cases offers less assurance that the project will be maintained on a long-term basis for low-income use. In addition, the forced sale of a cooperative project to a private owner often brings increased upward pressure on rent levels, resulting in higher subsidy costs for the federal government and displacement of those tenants who do not receive Section 8 rental assistance.

Not only are many nonprofits and cooperatives being forced to sell their projects, but also HUD provides little in the way of technical assistance to assure that the purchasing entity does not take undue advantage of its superior bargaining position and pay less for the project than its true value or invest less in the project than the project's needs would dictate. The 1981 tax act substantially increased the tax-shelter value of subsidized properties, and we have seen some incredible attempts by private investors to purchase projects for a fraction of their real worth. HUD's pressure on nonprofits and co-ops to sell their properties only increases these problems.

Foreclosure and Continued Use Restrictions

The Housing and Community Development Amendments of 1981 (Pub. L. 97-35, §367(b)) established a congressional policy favoring continued use of low-income housing as low-income housing following the foreclosure sale in those instances where HUD was not the high bidder at the sale. See also Joint Explanatory Statement of the Committee on Conference, accompanying H.R. Rep. No. 208, at 715 (1981). HUD has proposed regulations that fail to effectively implement the congressional intent concerning continued low-income use. See 47 Fed. Reg. 51,406 (Nov. 15, 1982). The regulations simply parrot the statutory language.

The statute requires the Secretary to impose continued use restrictions on projects that are more than half occupied at the time of sale. The statute gives the Secretary discretion to impose use restrictions upon the foreclosure purchaser in any situation where less than a majority of the units are occupied. HUD has done nothing to explicitly state the type of use restriction that it will impose or the conditions under which it will impose restrictions for those projects subject to its discretion. If the Secretary does not allocate Section 8 subsidies tied to these units, but simply provides, for example, Section 8 certificates to the tenants, the units will eventually be lost to low-income use. We have heard that HUD is considering using only certificates for these projects. In view of the critical shortage of affordable low-income housing units and the cutbacks in the federal production programs, such a decision would be inconsistent with national needs and the congressionally established housing goals. See, e.g., 42 U.S.C. §§1441, 1441a; 12 U.S.C. §1701t.

While HUD is cracking down on delinquent mortgagors, it is also taking steps to ensure that fewer of these projects come into HUD ownership by reducing the price that HUD bids at the foreclosure sale. While formerly the agency bid 90 percent of the outstanding balance of the mortgage, HUD is now discounting its bid by its estimated holding costs. HUD will therefore be outbid at the foreclosure sale with increasing frequency, making the problems mentioned above concerning use restrictions even more critical. Moreover, units that are in the best projects and best neighborhoods -- those that would have the best chance of providing decent and affordable housing for low-income tenants -- will likely be the most attractive for private investors. HUD's policies will therefore have the effect of eventually siphoning away the best projects from the low-income stock. While such a result might make HUD's balance sheets meet with the approval of the Office of Management and Budget, it hardly squares with congressional intent and HUD's duties under the federal housing legislation.

HUD Ownership and Management and Property Disposition

Once a project comes into HUD ownership through foreclosure, Congress has established statutory policies which again favor retaining the projects for lower income housing. The Housing and Community Development Amendments of 1978 require HUD to manage and sell HUD-owned formerly subsidized multifamily projects in the manner that balances financial and social goals. 12 U.S.C.A. §1701z-11 (West Supp. 1981). HUD has adopted regulations implementing the statute which for the most part adequately carry out the congressional directive. In several notable instances, however, HUD's actions and policies are inconsistent with congressional intent and jeopardize the continued availability of units for low-income use.

First, HUD has adopted a policy to sell projects with the requirement that the purchaser perform any necessary repairs. As many of these HUD-owned projects are in poor physical condition and remain in the HUD inventory for some time, the requirement that all but emergency repairs be deferred until the sale of the project often results in significant unnecessary deterioration.

Second, and often as a consequence of the lack of good management and adequate repairs, and sometimes deliberately, units are not rented and remain vacant, with resulting vandalism and boarding up. As a result, units are lost not only from present low-income use, but possibly forever. In some cases, for example, with the Stone Key II project in Indianapolis, vacancies increased significantly during the period of HUD ownership.

Third, in some cases HUD has violated the requirements of its own regulations concerning subsidies to be provided with projects upon sale to continue their availability to low-income people. This has occurred in a number of cases, including Cincinnati (several projects), San Antonio (Richard Allen Villa), and Indianapolis (Stone Key II). In another case, King's Manor in Pasadena, HUD has allowed more than 100 units of a 400-unit formerly subsidized project to be converted to condominiums as part of the sale transaction. In Chicago, HUD sold a formerly unsubsidized project without a proper determination of the need for subsidies. In most of these cases, tenants and potential residents of the projects have been forced to seek judicial remedies to ensure HUD compliance with its own rules and congressional policies.

Fourth, HUD is proposing to sell many of the projects in its inventory on a "bulk sale" basis in an effort to maximize its financial return. While such a program is not always inappropriate, it obviously operates to effectively prevent any nonprofit or cooperative groups from competing in the bidding process and in some cases jeopardizes the long-term availability of the units for low-income use. The increased tax-shelter value of these properties resulting from the 1981 Tax Act also works to increase prices artificially for the better projects, making it difficult for nonprofits to compete.

IV. SECTION 8 FAIR MARKET RENTS

In the Section 8 Existing housing program, Congress has permitted HUD to establish the fair market rent (FMR) levels that set the upper limit on the contract rent that an owner can receive for a unit as a result of tenant and HUD (via the PHA) payments. Until now, HUD has used the median rent (50th percentile) for standard quality units rented by recent movers in the market area by unit size. HUD has recently proposed to change the methodology for calculating the FMRs, the ostensible objective being to reduce the FMRs and thereby reduce program costs. 47 Fed. Reg. 55,764 (Dec. 13, 1982). HUD's proposal would use the 40th percentile of all standard quality units in the area (not just those rented by recent movers) to establish the FMR for any given area. FMRs would drop by an average of about 15 percent under HUD's proposal, even after considering the fact that FMRs have not been adjusted since March 18, 1981 (46 Fed. Reg. 17,367).

HUD has received hundreds of negative comments on its proposal from PHAs and tenants. These comments document that fact that even fewer units will be available to Section 8 tenants, resulting in many unused certificates and much wasted effort. Moreover, the statutory objectives of the program, such as decent housing and tenant mobility, will be drastically undercut as tenants are forced to rent substandard units in concentrated areas in order to receive the benefits of any subsidy. For example, in Santa Cruz County, California, out of 1,200 rental units surveyed, the PHA found that only 40 units were eligible for Section 8 lease approval under the present FMRs. Under HUD's proposal, only four units (or 0.33 percent) would be available to tenants. See comments of Santa Cruz County Housing Authority submitted to HUD, Docket No. R-82-1029. Similar results, practically destroying the program, will occur in many of the nation's high-cost housing markets that have few decent, safe and sanitary, affordable units.

The bill reported by this Committee last year contained a provision directed toward this problem, but it is not adequate. See S. 2607, §202(c). It merely required, for the modified Section 8 program, that the formula for setting the payment standard be established in a regulation and that it exclude substandard units. HUD's current proposal to set the FMRs at the 40th percentile of all existing, standard units would meet those requirements. Yet it is that HUD proposal which in causing the problem, as the comments submitted to HUD demonstrate. Thus, the statute must contain a provision requiring HUD to retain the existing methodology (median rent paid by recent movers) to calculate FMRs.

V. TENANTS' RENTS SHOULD BE MAINTAINED AT 25 PERCENT OF ADJUSTED INCOME.

Since 1965, Congress has determined that low-income families should pay no more than 25 percent of their income for rent. (See 12 U.S.C. §1701s Rent Supplement Program). Until the passage of the Omnibus Budget Reconciliation Act of 1981, Congress had consistently applied this principle to all low-income housing programs. See 42 U.S.C. §1437a (Public Housing); 42 U.S.C. §1437f (Section 8); 12 U.S.C. §1715z-1(f)(2) (Section 236 RAP). The most recent Annual Housing Survey (1979) shows that the median percentage of income spent on rent by renters of all incomes has just increased to 26 percent. The percentage of income spent on housing dramatically declines as income increases. The median rent for a family in the $20,000-$25,000 income range is 16 percent of income. Thus, the richer you are the smaller the bite for housing. Low-income families who typically expend all monthly income on basic necessities of food, shelter, clothing and medical expenses should not be forced to choose one necessity over another or to pay a greater percentage of income for rent than the average American.

Congress should adhere to the principle that low-income tenants' rents should not exceed 25 percent of income, and should reinstate this rent-income ratio. This Committee's bill should include a provision doing so. In fact, the bill should go further to set the rent-to-income ratio even lower for families with the lowest incomes, because they need more than the remaining 75 percent of their incomes to cover basic necessities after the rent has been paid.

VI. TREATMENT OF FOOD STAMP BENEFITS AS INCOME

The Administration indicates that it will again try to convince Congress to require that food stamps be treated as income when rents under the housing programs are calculated. Food stamp benefits are designed to supplement minimal welfare grants, unemployment compensation, and inadequate earned incomes to ensure adequate nutrition. To turn around and take that supplementary assistance away from tenants participating in the housing programs is inconsistent with the premise and the purposes of both the housing and the food stamp programs. The full Congress recognized that last year when it rejected the Administration's proposal when reauthorizing the food stamp program. This Committee should include in its bill a provision amending the housing legislation to prohibit the treatment of food stamps as income under any federal housing programs. Attached to this statement is proposed statutory language that would do so.

VII. TREATING HOUSING SUBSIDIES AS INCOME

In 1981, Congress adopted legislation that authorizes state welfare departments to treat federal housing subsidies as income under the AFDC program. 42 U.S.C. §602(a)(7)(C). Various welfare departments are beginning to take advantage of that provision. Treating housing subsidies as income for AFDC purposes will have disastrous consequences for both the tenants and the landlords, including PHAs, operating under the housing programs. When the housing subsidies are treated as income, the shelter portions of the AFDC grants will be reduced, dollar for dollar, by an amount equal to the subsidy. In many situations the tenants will not have enough money after the changes to pay even their share of the rent. That will cause excessive rent collection problems for the landlords and in some situations will threaten the financial stability of the projects. The reduction in the tenants' welfare grants will also increase the housing subsidy. Thus, part* of the savings in the welfare program will merely increase the federal expenditures under the housing programs.

A housing subsidy does not create a financial windfall that should be taken away from the family through the welfare program.

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*If the rent-to-ratio income ratio under the housing program is 30 percent, 30 percent of the AFDC savings will be borne by the housing subsidy and 70 percent by the tenants.

The very purpose of the housing subsidy is and always has been to provide decent housing which the family could not rent in the absence of the subsidy. That "value" should not be taken from the family. The subsidy also reduces housing cost to affordable levels, but that does not duplicate the welfare grant. The premise of the welfare programs is to provide at most the bare minimum income needed for survival and, in many cases, only a ratably reduced portion of the bare minimum. Housing subsidy programs are designed to provide a supplement to such bare minimum income, in order to make available to poor people the decent housing which will increase their opportunities and their children's opportunities for decent lives.

Every time this Committee has faced this question in the past, it has consistently said that housing subsidies should not be treated as income for other welfare programs. Last year, this Committee included in its housing bill a provision repealing the portion of the 1981 Reconciliation Act that caused this problem. See S. 2607, §211. Except for the ill-considered Omnibus Budget Reconciliation Act of 1981, the full Congress has always agreed with this Committee's position. That is true with housing subsidies and the food stamp program (7 U.S.C. §2014(d)(1)); housing subsidies and the SSI program (Pub. L. No. 94-375, §2(h), 90 Stat. 1068, noted at 42 U.S.C.A. §1382); Farmers Home Administration subsidies and all welfare programs (42 U.S.C. §1490a(a)(1)(3)); and the Uniform Relocation Act replacement housing payments and all welfare programs. 42 U.S.C. §1436. The legislative history of each of these provisions reflects the congressional judgment that it is unwise, unfair and counter- productive to treat housing subsidies as income for welfare. The Congress must adhere to this judgment and adopt a provision preventing the treatment of housing subsidies as income. We have attached to this statement suggested language for such a provision (Attachment B).

VIII. CAPPING RENT INCREASES WHEN RENT SUPPLEMENT TENANTS ARE CONVERTED TO SECTION 8

In what may be an administrative oversight, HUD has neglected to state clearly that the statutory 10-percent cap on rent increases for existing tenants (imposed by Pub. L. 97-35, §322(i)) applies to tenants whose income is recertified as a result of the 1981 Amendments and/or who are involuntarily converted from one program to another. The need for the cap is especially acute for elderly tenants receiving Rent Supplement benefits or who are converted from Rent Supplement to Section 8 because formerly there was no income recertification requirement for elderly Rent Supplement tenants. As a result of the lack of any HUD policy, some of these elderly tenants are facing extraordinary rent increases of 50 to 100 percent and more.

We think that existing legislation should be adequate to take care of this critical problem. The 1981 Amendments (§322(i)) state that "the Secretary shall provide that the amount of rent paid by any family shall not increase, as a result of the amendments made by this section . . . by more than 10 per centum during any 12-month period unless the increase above such 10 per centum is attributed solely to increases in income which are not caused by such amendments . . ." (emphasis added). Because the recertification of elderly Rent Supplement tenants is in fact an "amendment made by this section," i.e., §322 (see §322(g)(3) which imposes the annual recertification requirement for Rent Supplement tenants), HUD should therefore implement the clear statutory mandate and impose the 10-percent cap on rent increases for these tenants (whether or not they remain on the Rent Supplement program or are converted to Section 8). HUD's proposed rule (proposed 24 C.F.R. §813.105(c)(1), 47 Fed. Reg. 57,963 (Dec. 29, 1982)), however, fails to do so and, if unchanged, will result in tremendous hardship for these tenants. Clarifying legislation may therefore be necessary if HUD refuses to act.

We have attached to this statement a proposal prepared by Mr. Steve Frederickson of Evergreen Legal Services in Seattle, Washington, that would resolve this problem and which we fully support. (Attachment C)

IX. PUBLIC HOUSING NEW PRODUCTION

Through the years, the public housing program has been the one viable program that provides decent, safe and sanitary housing to low-income families at the least cost to the federal government. The fact that the public housing program is a comparatively cheap program has been recognized repeatedly. Last year the President's Commission on Housing even noted that the median cost for public housing units, including operating subsidies and subsidies for debt service and modernization, is much lower than the subsidy projected for its voucher payment program. The costs are much lower because the debt service on older projects is fixed and, over time, pales in comparison to the debt service paid for housing on the private market, even for existing housing. _See also_ U.S. General Accounting Office, _Section 236 Rental Housing -- An Evaluation with Lessons for the Future_ (January 10, 1978).

Although the general public believes that public housing projects are highrise, run-down, mismanaged, and crime ridden, in fact most public housing is low-rise, decently maintained, well managed, financially solvent, and most importantly, appreciated by the tenants. HUD, Office of Policy Development and Research, _Residents' Satisfaction in HUD-Assisted Housing_, 3-1, 3-5 (March 1979). The waiting lists for public housing are staggering and greatly underestimate the need. In the private market, families with children, minorities and single-parent households, even with HUD assistance, face great difficulty finding housing. Even in the Section 8 New Construction program, nonwhites are substantially under-represented. _See_ Vernarelli, _Integration and_

Section 8 New Construction, HUD, Division of Housing Assistance Research (April 1981).

Thus, it is clear that a new construction public housing program is needed if low-income families, especially minorities, families with children, and nonelderly adults are to be adequately housed. Congress should authorize at least 35,000 new units of public housing. This number of units, although relatively modest in comparison with prior years, is consistent with the starts and completions currently being experienced.

X. SECTION 8 EXISTING AND VOUCHERS

The Section 8 Existing housing program is a viable housing program in certain housing markets, where the vacancy rate is higher, for tenants needing units with fewer bedrooms, for the elderly, and for nonminority families. Because the Section 8 Existing housing programs meet a real need in certain housing markets and among specific classes of low-income families, we support an authorization of 100,000 additional units of Section 8 Existing housing.

The Administration is reviving its voucher proposal as a replacement for the Section 8 Existing housing program, under a new name, the Housing Payment Certificate (HPC) program. See HUD Budget for FY '84, p. H2-H3. It is apparent that the program would still vary to the detriment of low-income tenants from the

Section 8 Existing housing program in three major ways. First, the tenant's subsidy would be for a fixed amount representing the difference between 30 percent of tenant income and a payment standard determined by HUD. A tenant would be required to pay more than 30 percent of income if he or she could not find a unit renting at the payment standard. In its budget documents HUD has revealed that $64.2 million of 1983 budget authority would produce only 34,190 units of Section 8 Existing housing, even if reserved for only five years, while it would produce 67,146 units under its HPC program. HUD 1984 Budget, p. H-5. Clearly, a 50-percent reduction occurs only because HUD's subsidy per unit will be much less under the HPC program. And it will be less because the tenants will pay the excess rents over the payment standard.

Second, the contracts with the PHAs would be fixed for five years. There would be no adjustments from HUD to pay increasing rents, utilities, etc. HUD is no longer contemplating the tenants would automatically have to pay annual increases out of their own pockets. However, through attrition and delayed reallocation upon turnover, fewer tenants will be served and the "savings" spread to the remaining tenants to cover increases in rent. At the end of the five years, the programs may be allowed to die completely.

Third, the HPC program will be worth less to any particular participant because the payment standards will be set well below the real market. Our experience with the Section 8 Existing fair market rents shows that they are already too low and make it very difficult and often impossible for people to find housing, especially minorities, single-parent households and large families. By proposing to subsidize twice as many families under its HPC program, it is clear that HUD will be setting the payment standards at half the Section 8 FMRs. Families may be able to find housing under the program, but they will have to pay exorbitant shares of their incomes for it.

XI. PUBLIC HOUSING OPERATING SUBSIDIES

In order to preserve the valuable stock of public housing units, operating subsidies for public housing must be adequate to ensure proper maintenance and repair. Inadequate operating subsidies are nothing more than a slow death for public housing. The lack of adequate funds over a period of time produces the "troubled projects" that, in turn, create substantial additional financial burdens on the federal and local governments. Tenants suffer because units are boarded up and unavailable, crime increases, the condition of the premises deteriorates rapidly, and morale and pride in one's living environment disappear.

While we recognize that there are some deficiencies in the performance funding system, HUD's current proposal to abandon that system and substitute one under which public housing subsidies would be based upon private market rents, and ridiculously low ones at that, is indefensible. Congress must direct HUD to continue with the performance funding system, with modifications within its basic framework, as needed. Under that system, there is a need, we understand, for about $1.6 billion of operating subsidies in fiscal year 1984. That amount should be authorized by the Committee.

XII. PUBLIC HOUSING MODERNIZATION

The need for public housing modernization is so apparent that even this Administration has requested an allocation of $70 million of contract authority (and $1.4 billion of budget authority) for FY '83, as part of its proposed operating subsidy system. As we noted above, we object to the proposed change in the operating subsidy system. We also think that the modernization program should be kept in place and funded at least at the level proposed by HUD. Given the state of many projects, the need for funds is greater. If the PHAs are able to absorb the funds, Congress should be prepared to authorize more modernization funds than HUD has proposed.

XIII. TROUBLED PROJECTS (FLEXIBLE SUBSIDY)

The flexible subsidy program for projects subsidized by the Federal Housing Administration (FHA), like the modernization program for public housing, is an invaluable tool for providing assistance to restore and maintain the low-income character of assisted projects through better management and improved physical conditions. When administered most effectively, this program can be used to leverage additional financial commitments by the owners. HUD's failure to provide the flexible subsidy to projects which are in need will be costly to the government because the projects will go into default, the mortgages will be assigned to HUD, and money will be drained from the insurance funds.

HUD proposes no new appropriations for the flexible subsidy program and the use of only $38 million from the Rental Housing Assistance fund and carryovers. That represents a reduction of over 30 percent ($18 million) from the 1983 estimated expenditures. It would aid only 110 projects nationwide. Our experience with the demand for flexible subsidies in California alone tells us that HUD's proposal is inadequate. Congress should authorize at least $100 million for the flexible subsidy program.

XIV. THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM

This administration's treatment of the Community Development Block Grant program (CDBG) is no different from its treatment of the housing programs. While it is not politically possible to eliminate the program entirely, or rescind or defer its appropriations, in the short term the regulations promulgated or proposed by HUD in 1982 de facto convert the CDBG program into a no-strings, general-revenue sharing grant. In the long term, the administration proposes to formalize this conversion by its introduction this year of a "mega block grant" which will merge CDBG funds with general-revenue sharing funds and, over a five-year period of time, cause the CDBG program to shed all remnants of federal purposes and objectives. Even though initial response by local officials clearly indicates that they regard this latest brand of federalism as a Trojan horse that will inevitably lead to decreased funding for the two merged grants, if the administration is not prevented from carrying out its short-term strategy, whether it ever accomplishes its final, formalizing touch of re-labeling the program will be irrelevant.

Already in the State-run and HUD-administered Small Cities Programs, and now in its proposed Entitlement Program regulations, HUD has totally abdicated federal oversight of the primary objectives of the Community Development Block Grant program which is to principally benefit low- and moderate-income people. HUD would authorize the annual transfer of approximately $3 billion from the federal government to state and local governments in purposeful disregard of whether those dollars reach statutorily-mandated, intended beneficiaries. HUD has tossed out regulations in effect since 1978 which were designed to implement the primary objective of the Act and instead, in the proposed Entitlement regulations, has flatly stated that it will no longer conduct any review of a grantee's overall program with respect to benefit to low-and moderate-income persons. The regulations which the administration would discard acknowledge that, while the local government's CDBG-assisted activities must give feasible priority to activities that either benefit the lower-income, or eliminate slums and blight, or meet an urgent need, the local government's program as a whole must conform to the primary objective of the Act by principally benefiting low- and moderate-income people. Instead, HUD will allow a local government to expend its entire CDBG allocation on activities that eliminate slums or blight or meet an urgent need, or a combination of both, in total disregard of the primary objective of the Act and the needs of the lower-income.

In its preamble to the proposed Interim Rule for the Entitlement Program published in the Federal Register on October 4, 1982, HUD justified its abandonment of the requirement that a CDBG program as a whole principally benefit the lower-income on the basis of its reading of legislative events in 1978. According to the present administration, HUD's regulations implementing the primary objective of the Act have been in excess of statutory authority since 1978. According to HUD, 1978 amendments to §104(c) of the Act stripped HUD of the authority to provide expedited application reviews if a local government earmarked in excess of 50 percent of its funds to activities benefiting the lower-income. HUD takes this position in spite of the fact that the Conference Report accompanying the 1978 amendments stated that the Conferees wishes to "reaffirm that the primary objectives of the CDBG program is the development of viable urban communities by providing decent housing and a suitable living environment and extending economic opportunities, principally for persons of low-and moderate-income." Conf. Rep. No. 95-1792, 95th Cong., 2d Sess. 60 (1978). HUD also ignores the Senate's view of the 1978 amendments, as reflected by Senator Proxmire's statement that, "The original House amendment would, I believe, have been a disaster. The compromise, I feel, reaffirms the primary objective of the Act, and the authority of Secretary Harris to administer the program in accordance with the policies she has established." 124 Cong. Rec. S.18773 (Oct. 14, 1978).

The Senate has never strayed from its commitment to ensuring that the lower-income receive principal benefits of the CDBG program. If HUD is allowed to usurp Congressional prerogative and re-write regulations that conform only to its own misguided view of the law, the result inevitably will be the same as in the early days of the program when there was no effort to ensure that CDBG program benefits were targeted to the lower-income. Numerous studies and administrative and court complaints have documented the abuses that took place in the first few years of the program. (For the most extensive listing of such abuses, see Keating and LeGates, "Who Should Benefit from the Community Development Block Grant Program?", 10 URBAN LAWYER 701 (Fall, 1978)). A NAHRO study, for example, found that more middle-income households than low-income households benefited from the CDBG program in 1975 and 1976. Id. at 712, fn. 50. And

Senate Oversight Hearings in 1976 turned up instances of golf courses, tennis courts, and swimming pools funded with CDBG program dollars. Oversight Hearings on the Administration of the Housing and Community Development Act of 1974 before the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. passim (1976).

Even if prior history did not compel the conclusion that HUD must regulate to ensure that low- and moderate-income people receive the principal benefits of the program, present-day policies of targeting scarce federal resources to the truly needy should mandate it. Rather than ignoring the statutory mandate, HUD should be carefully regulating to ensure that the most needy do in fact receive the benefits of the CDBG program. Instead, HUD is consciously and purposely choosing to abandon targeting requirements in defiance of this legislative body's directive.

We thank you for this opportunity to express our views to the Subcommittee. If you have questions or need further information, we remain available to be of assistance.

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PROPOSED STATUTORY LANGUAGE TO PRESERVE THE CURRENT PUBLIC HOUSING LEASE AND GRIEVANCE PROCEDURES

_____/. Section 6 of the United States Housing Act of 1937 shall be amended by adding a new subsection (h), as follows:

(h) The Secretary shall by regulation require each public housing agency receiving assistance under this Act to:

(1) Establish and implement an administrative grievance procedure that will provide public housing authority (PHA) tenants and applicants an opportunity to be heard, in accordance with the basic safeguards of due process, regarding PHA actions or failures to act which adversely affect their rights, duties, welfare or status; and

(2) Utilize leases which:

(A) Do not contain unreasonable terms and conditions;

(B) Obligate the PHA to maintain the projects in a decent, safe and sanitary condition;

(C) Require the PHA to give adequate written notice of termination of the lease, which shall not be less than (i) fourteen (14) days for nonpayment of rent; (ii) a reasonable time when the health or safety of other tenants or PHA employees is threatened; and (iii) thirty (30) days in all other cases; and

(D) Require that the PHA shall not terminate the tenancy except for serious or repeated violation of the terms or conditions of the base or for other good cause.

PROPOSED LEGISLATIVE HISTORY REGARDING THE PUBLIC HOUSING LEASE AND GRIEVANCE PROCEDURES

The Department of Housing and Urban Development is proposing to repeal the current regulations (24 C.F.R. Part 866) which establish model leases and grievance procedures for public housing. Those regulatory requirements were initially developed in 1971, after extensive negotiations with representatives of the housing authorities (NAHRO) and tenants (NTO). They grew out of dissatisfaction with the practices of some, but not all, public

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housing authorities (PHAs) and PHA employees that caused unfairness in the leasing and operation of PHA projects. They reflected judicial decisions regarding the minimum level of fairness required of government agencies which are landlords. They were designed to provide a realistic means for resolving disputes between tenants and PHAs quickly and fairly, before the problems fester and hostilities develop. HUD's power to issue the regulations and the reasonableness of its judgment in doing so were sustained in court after court. The regulations themselves were readopted in 1975, after an extensive two-year review by new HUD officials with widespread input from PHAs, tenants and other members of the public.

Given that history, it is the judgment of the Committee that these lease and grievance requirements must be retained. Thus, Section ____ of the bill adds a new subsection to Section 6 of the Act, under which the Secretary must by regulation require PHAs to maintain grievance procedures and utilize fair leases. The Committee contemplates that HUD will meet this obligation by retaining the present regulations. The grievance procedures shall be available for all disputes between a PHA and an applicant, a tenant or a former tenant. The hearings shall be made available on an administrative level, because attempting to resolve these matters only in court is not a desirable, efficient and effective approach. The procedures must meet the requirements of due process, including (1) adequate notice to the tenant of the grounds for the PHA's action; (2) an opportunity for the tenant to examine all relevant documents, records and regulations of the PHA in order to meet the PHA's case; (3) a right to be represented by counsel or other representative; (4) a right to present witnesses and other evidence and to confront and cross-examine opposing witnesses; (5) an impartial decision-maker; and (6) a decision based solely on the record and explained in writing.

The PHA leases must not contain unreasonable, unfair or unconscionable provisions, such as requirements that the tenants waive rights granted by state or federal law. Since 1970 HUD has prohibited PHAs from utilizing the following types of unfair clauses: confession of judgment; distraint clauses; exculpatory clauses; waivers of legal notices; legal proceedings, jury trials and appeals; and clauses requiring tenants to pay legal costs regardless of the outcome. 24 C.F.R. §866.6. The Committee contemplates that those regulatory prohibitions will be retained and that HUD will prohibit as well any additional clauses which are unreasonable.

Beyond prohibiting certain unfair clauses, the amendment will also require the leases to contain certain basic protections. They include clauses obliging PHAs to maintain the premises in decent, safe and sanitary condition, and to provide adequate notice before evicting tenants. The present regulations spell out the reasonable points which should be covered in each PHA lease for the protection of both the PHAs and the tenants. Again, the Committee contemplates that HUD will retain the regulations as they currently stand.

PROPOSED LANGUAGE PROHIBITING THE TREATMENT OF HOUSING SUBSIDIES AS INCOME

Notwithstanding any other provision of law, the value of any assistance paid with respect to a dwelling unit under any of the federal housing programs, including, without limitation, programs authorized by the United States Housing Act of 1937, the National Housing Act, Section 101 of the Housing and Urban Development Act of 1965, as amended, Title I of the Housing and Community Development Act of 1974, Title V of the Housing Act of 1949, Section 202 of the Housing Act of 1959, and Section 312 of the Housing Act of 1964, shall not be considered as income or a resource for the purpose of determining the eligibility of or the amounts of benefits payable to any person for assistance under any federal, state or local laws including, but not limited to, laws relating to welfare and public assistance programs.

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PROPOSED STATUTORY LANGUAGE TO CLARIFY 10-PERCENT CAP ON RENT INCREASES ASSOCIATED WITH RENT SUPPLEMENT/SECTION 8 CONVERSIONS

_____/. Section 322(i)(1) of the Housing and Community Development Amendments of 1981 shall be amended by inserting the following underlined material:

(i)(1) in determining the rent to be paid by tenants who are occupying assisted housing under the authorities amended by this section on the effective date of this Act, the Secretary, notwithstanding any other provision of this section may provide for delayed applicability, or for staged implementation, of the procedures for determining rent required by the provisions of subsections (a)through (h) of this section if the Secretary determines that immediate application of such procedures would be impracticable, would violate the terms of existing leases, or would result in extraordinary hardship for any class of tenants. The Secretary shall provide that the amount of rent paid by any family shall not increase as a result of the amendments made by this section, as a result of conversion from the Rent Supplement Program to the Section 8 Program and accompanying recertification of income, and as a result of any other provision of federal law redefining which governmental benefits are required to or may be considered as income, by more than 10 per centum during any 12-month period unless the increase above such 10 per centum is attributed solely to increases in income which are not caused by such amendments, or by such redefinitions. The limitation contained in the preceding sentence shall remain in effect and may not be changed or superceded except by another provision of law which amends this subsection. Notwithstanding any other provision of this section, application of the procedures for determining rent contained in this section shall not result in a reduction in the amount of rent paid by any tenant below the amount paid by such tenant immediately preceding the effective date of this Act.

PROPOSED REPORT LANGUAGE TO EXPLAIN THE PROPOSED AMENDMENT THAT WOULD CLARIFY THE CAP ON RENT INCREASES ASSOCIATED WITH CONVERSIONS FROM THE RENT SUPPLEMENT PROGRAM TO THE SECTION 8 PROGRAM

Section 322 of the Housing and Community Development Amendments of 1981 authorized a number of changes regarding tenant rental payment in assisted housing. The changes included a requirement that all tenants in assisted housing, including senior citizens, recertify their incomes annually for the purpose of making any necessary adjustments in tenants' rents and that

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any rent increases caused by the amendments made in Section 322 or by the redefinition of income shall not result in a rent increase of more than 10 percent during any 12-month period. The Committee has learned that the 10-percent cap on rent increases has not been uniformly followed with respect to tenants who are being involuntarily converted from the Rent Supplement Program to the Section Program. This amendment merely clarifies that rents shall not be increased by more than 10 percent in connection with the conversion process.

The Rent Supplement Program was authorized by the Housing and Urban Development Act of 1965. The Act provided that tenants receiving Rent Supplement payments were not required to recertify their income on an annual basis beyond the age of 62. It was felt that elderly tenants would not ordinarily experience annual increases in income which were substantial enough to warrant annual recertifications. Despite the 70-percent cap on Rent Supplement payments, many elderly tenants did not experience significant rent increases under the Rent Supplement Program during their participation.

In 1982, owners of federally subsidized multifamily housing projects around the country were afforded the opportunity to convert from the Rent Supplement Program to the Section 8 Program. Existing tenants in the buildings were required to recertify their incomes in connection with the conversion process and their rents were adjusted accordingly. For many senior citizen tenants, the conversion to the Section 8 Program and the accompanying recertification of incomes resulted in significant rent increases based on the cumulative effect of modest annual increases in Social Security benefits or pensions which had previously not been taken into consideration. The Committee has learned that many tenants in their 70s and 80s who have lived in their subsidized projects for over 10 years experienced sudden and substantial rent increases as a result of the conversion to Section 8 and the accompanying recertification of their incomes. For example, two tenants ages 76 and 86 had their rents increased from $29 per month to $67 per month; one tenant age 79 had her rent increased from $63 per month to $92 per month; and one tenant age 7 had her rent increased from $75 per month to $110 per month. These increases, particularly for senior citizens, were an unforeseen and unintentional consequence of the conversion and recertification process and would have been dealt with more explicitly in the Housing and Community Development Amendments of 198 had they been anticipated as a problem.

The proposed amendment of Section 322 of the Housing and Community Development Amendments of 1981 merely clarifies that rent of assisted families shall not be increased more than 10 percent per year as a result of the conversion from the Rent Supplement Program to the Section 8 Program and accompanying recertification of income. This means that modest annual increases in Social Security benefits, pensions, or other public or private sources of income, which have not previously been taken into consideration in determining rents because of the lack of an annual recertification requirement, shall not be considered cumulatively for the purpose of imposing a sudden and, in many cases, substantial rent increase. Rather, it is the intention of the Committee that increases in rents caused by increases in income which took place during a time that recertification was not required be phased in so that annual rent increases do not exceed 10 percent. This amendment should be applied retroactively to any tenants who have been converted to the Section 8 Program from the Rent Supplement Program since October 1, 1981, and as to those tenants, rents should be recomputed and adjusted accordingly.

Ms. ROISMAN. Thank you, I will. I should say that the information and the judgments that we can offer to the subcommittee are secured from our work with thousands of legal services attorneys who represent the many millions of low-income people in this country who have grave housing problems.

Those people include the elderly and disabled and families with young children who have no source of income other than public assistance or private pensions. They include the new poor, people who have worked hard all their lives taking care of themselves and their dependents and now find themselves absolutely unable to care for themselves and faced with the loss of their homes either by eviction or by foreclosure; and I regret to say that our millions of clients include also people who have worked all their lives and are continuing to work now, frequently families with two working parents who are, despite the fact that both adults are out working hard, simply not able to pay the housing costs and other subsistence costs that face them in this economy.

There is no doubt that the overriding problem for all of these people is that the supply of low rent, low cost housing is egregiously inadequate to meet the need and Cushing has, as she always does, set out in her oral statement and in her written testimony the dimensions of the need relative to the supply. I won't say anything more about that.

I would like to speak to three of the issues that we dealt with in our statement.

STOCK OF PUBLIC HOUSING

The first is the stock of public housing and FHA-subsidized housing of which HUD is the custodian. HUD is the custodian of a vital national resource. Both Cushing Dolbeare and Mr. White have referred to that stock of housing. I'd like to speak about it at a little more length.

We have millions of units that were built with Federal money to serve the national purpose of providing decent housing for low-income people. It's the public housing stock. It's FHA-subsidized projects that have gone into default and now are owned by HUD and are in the process of being disposed of by HUD. It's also FHA-subsidized projects that are still held by private, nonprofit or limited-profit sponsors. Some of those projects are troubled financially. Some of them are not troubled financially. But what that entire stock represents is the easiest, least expensive, readiest-to-hand supply of housing for lower income people.

We have always needed that stock of housing. That's why the Congress appropriated billions of dollars to provide it. Now we need it more than ever. We have no program for producing low-rent housing for families and the little that is produced for low-rent elderly use is so far from meeting the need that it scarcely merits discussion.

Today more than ever that stock of federally financed housing is absolutely essential. Yet HUD in an incredibly irresponsible way is not only permitting but encouraging the loss of these units from the service of the public. HUD is promoting the demolition of public housing units and of FHA subsidized units. It is encouraging to a very large extent the conversion of those projects from the service of low-income people to the service of much higher income people.

It is encouraging the transformation of ownership from public ownership or private nonprofit ownership to private oriented ownership for higher income people.

The analogy it seems to me is the loss of national resources in mining, timber and mineral rights. The Congress has been very careful in general to prevent a hemorrhaging of these resources from the public service to private service, and I think that it is essential that Congress direct the same kind of attention to that problem in housing.

The second issue that I'd like to address is one that I suspect only we will address, and that is the model lease and grievance procedure in public housing. In many areas of the law, as you doubtless know, there is great effort being expended to ameliorate the burden on the courts, the Federal courts, and the State courts also, to develop methods of alternative dispute resolution. Many judges, many lawyers, many arbitrators devote considerable attention to taking things out of the court system and putting them into another discrete resolution system.

HUD is trying to take a gigantic and totally unjustified step in exactly the opposite direction. That's the problem with respect to the public housing model lease and grievance procedure.

Twelve years ago in a Republican administration, after negotiations with public housing authorities and tenants, HUD developed and then incorporated into formal regulations the model lease and grievance procedure for public housing which sets up an administrative procedure in each public housing authority for resolving disputes between the authority and the tenant, every kind of dispute—disputes about how much rent is supposed to be paid and whether it's been paid, disputes about whether windows have been broken and whether tenants are noisy, disputes about whether the housing authority is keeping the property up to standard, every conceivable dispute that can come up in a landlord-tenant concept is dealt with, has for the past decade been dealt with by each local public housing authority working with its own tenants. This is a system that has worked.

ELIMINATION OF MODEL LEASE AND GRIEVANCE PROCEDURE

HUD has proposed the elimination of the model lease and grievance procedure. HUD has offered two reasons for this, neither of which is true, to speak frankly.

HUD says, first of all, that the administrative grievance procedure doesn't enable public housing authorities to deal with situations where the health and safety of tenants are threatened. This is flatly contradicted by the regulations. The regulations expressly authorize the housing authority to disregard the administrative procedure wherever the health and safety of tenants is threatened.

The second explanation that HUD has offered is that it takes more time to use an administrative grievance procedure than it would take to go to court. Well, that's simply not true. It isn't true. The grievance procedure requires that 30 days notice be given where the issue is something other than nonpayment of rent and that only 14 days notice be given where the issue is nonpayment of rent. So on its face it appears that there is a delay added by the grievance procedure, although the delay is only 30 days where it's a nonrent issue and 14 days where it is a nonpayment issue.

But the reality, of course, is that issues that can be dealt with and disposed of in an in-house, administrative proceding, within a public housing authority, takes infinitely less time than issues that have to go to litigation, whether the litigation is in the State court or in a Federal court. Litigation always takes longer than administrative adjudication.

I think the conclusion is inescapable, that the real reason for HUD's having proposed the elimination of the grievance procedure for evictions and the other amendments to the model lease and grievance procedure is that HUD has made the judgment that fewer issues will be disputed if the only forum for a dispute is a court than if an administrative procedure is available.

I think that's true, but I suggest that examination of that proposition will lead to the conclusion that the lease and grievance procedures should be maintained.

If the administrative procedure is eliminated altogether the only thing that a tenant can do to contest something with a housing authority is to go to court; most tenants won't go to court. What will happen to those tenants is that they will be embittered; frequently—more frequently than not—it turns out when the dispute goes to arbitration that the tenant was right and the housing authority wasn't, so people will have been treated unfairly; and the tenants will have lost what is housing of last resort. Where on earth will people go if they have to leave public housing?

But even if one is not affected by the impact on the tenants who choose not to go to court, not to get into a contest with the housing authority, look at the impact with respect to those tenants who do both, and many of them will.

The litigation is going to take more time. It's going to cost everybody money. It probably won't cost the tenants money because the tenants are poor people and they get free counsel or no counsel. It's certainly going to cost the housing authority money. It's going to use up the courts' time and going to engender hostility and produce inconsistency even within one State. Different judges will reach different conclusions. But from State to State we will have a situation in which the standards governing the Federal public housing program will be different depending on what State the tenant is in.

MASSIVE CHANGES IN STATE COURT PROCEEDINGS

And finally, if all these issues have to go to litigation, there's absolutely no doubt in my mind that what will happen is that there will be massive changes in the State court proceedings. The reason HUD in 1971 began this model lease and grievance procedure was because a series of Federal courts of appeals had held that as a matter of constitutional entitlement. An administrative grievance procedure was required before public housing tenants could be evicted The second circuit, the fourth circuit, and other Federal courts held that the due process clause was violated if a public housing authority tried to evict a tenant without first providing an administrative hearing.

Now those were not then and are not now particularly liberal courts of appeals, neither the second circuit nor the fourth circuit is outside the mainstream of the Federal courts of appeals, and I do not have the slightest doubt but that if these regulations are eliminated and we have to go back to litigating this issue, we are going to win those cases; but I think it is as a policy matter senseless for HUD to create a situation in which the Federal courts and the State courts have to go back to dealing with these issues.

These issues should be dealt with as they have been dealt with for the last decade—within the public housing authority, giving an administrative hearing.

The last issue that I would like to address is the administration's voucher proposal.

Senator **Tower**. Would you suspend, Ms. Roisman. Senator Riegle and I have to go vote. Those noises you're hearing there are indications that a vote is on and the warning bell has run and we have about 5 minutes to get there. So if you will suspend, we will be back in about 10 or 15 minutes and we will continue your testimony at that time.

[Recess.]

Senator **Tower**. The committee will come to order.

Ms. Roisman, I apologize for the interruption, but we don't control the activity on the floor from here and would you please resume your testimony.

Ms. **Roisman**. To say that I understand is an understatement, Mr. Chairman.

VOUCHER PROGRAM

The last issue that I wanted to address and will address very briefly is that of the voucher program as proposed by the administration.

I just want to make two points. First, for many people a voucher program just won't solve the problem because there are a great many people for whom the housing problem is not just a money problem and those are blacks, hispanics and other minorities, female-headed households, single-parent households, generally people in rural areas, farmworkers, people with very large families. No voucher program is going to take care of those people. There must be a Federal production program for low-income people.

The second point is that there are some people for whom a voucher or certificate or housing allowance kind of program has been shown to be very effective, but for those people three conditions have to be met. I may just be repeating what Cushing said, but I suppose it's important so I will repeat it.

First of all, the amount that the tenant pays has to be affordable. Thirty percent isn't affordable for very low income. Twenty-five percent isn't affordable either and certainly the 30 percent isn't affordable.

Second, the payment standards has to be realistic and HUD has made clear that it is not proposing a realistic payment standard. Indeed, with respect to the existing section 8 program, HUD is endeavoring to reduce the payment standard to the 40th percentile and to change the measure so that instead of taking into account recent moves into standard housing of appropriate size, the payment standard would be set with reference to all units, not just units recently occupied. That's entirely unfair and unrealistic.

HUD estimates that the payment standard would be reduced by about 15 percent by this shift from the median percent in the recent moves to 40 percent of all standard units, and what that would mean is that the family would be paying not only 30 percent of its income but then a big surcharge in order to secure standard housing. So that if there's going to be some kind of voucher program, there has to be a realistic and fair way of setting the payment standard and if what we're going to have is what we have now, the existing section 8 program, we urge the committee to require in the statute that HUD use the payment standard it's been using up to this point, which is the median rent level for recent moves and that the committee not let HUD change that to the 40th percentile for all units.

And the third and last point I would make about the administration's proposal is that it contemplates a 5-year fixed payment by HUD so that as rents go up, as costs go up, there would be no increased contribution from HUD. Again, obviously that means that the housing authority is going to have to be paying more money and since the housing authority has no other income to support this, what will happen is that the number of households being supported on a program will decrease. Fewer families will get help under the voucher program if the amount stays fixed for 5 years.

The reason that the program we have now has a provision for adjustments is because costs do increase and rents do increase and if the tenant isn't going to pay the increase, then the public agency has to because otherwise fewer people are going to be assisted.

I have nothing else, Mr. Chairman.

Senator TOWER. Thank you very much, Ms. Roisman. Let me ask you and Mrs. Dolbeare what do you recommend in lieu of the 30-percent requirement? Perhaps you touched on that and I didn't catch it.

Mrs. DOLBEARE. You mean the 30 percent of income requirement for rent?

Senator TOWER. Yes.

Mrs. DOLBEARE. That was adopted in 1981 as part of the reconciliation act and increased from 25 percent, and the recommendation that we would make, which has not I think ever been put in legislative form, recognizes the fact that the lower your income is, the less you can afford to spend on housing. Therefore, we would propose a sliding scale where you divide households by size into percentiles and the bottom percentile would pay 1 percent and the second percentile would pay 2 percent and the 10 percentile would pay 10 percent and the 25th percentile would pay 25 percent, and so forth. That would both provide the most assistance for the lowest income families and it would almost eliminate the need, if you have a minimum subsidy, for any kind of income limits because at some point the subsidy line and the percentage of income line would cross and you would no longer qualify for the program.

We suggest that that would be an equitable way of doing it. There's no real way of determining exactly what affordability is, but at least this fits with everybody's understanding of who needs the most help, provides the most help for the lowest income people, and bears some relationship to capacity to pay which would mean that everybody pays something. By stepping it percent by percent, you would not inflict a major penalty as incomes rose slightly. If you did it in 5-percent jumps, then you would have a notch problem, but we think that this would be a reform which would cost some money initially but which would be recognized as good and fair, and I think one of the things that our housing programs badly need is to get a perception as being not quite as inequitable as they sometimes seem to be.

Senator TOWER. Do you have that formula proposal reduced to writing?

Mrs. DOLBEARE. I would be glad to provide it.

Ms. ROISMAN. If I might add to that, Mr. Chairman, that proposal recognizes what I think most people who work in the area recognize, and that is that it's not enough just to take a flat percentage of income. The lower the income and the more people in the household, the smaller amount of money is available to be devoted to housing. Prof. Michael Stone at the University of Massachusetts has written a book which is about to be published about this shelter poverty notion and I think we can make available to the committee some of his materials.

Senator TOWER. The committee would be delighted to have any additional material you want to provide. Well, I see that my colleague has left. I want to thank all of you for your presentation today. It will be enormously useful to us as we deliberate these issues. Hopefully, we will have a bill out for you in a timely fashion and we of course then welcome any comments and suggestions you have once the bill has been marked up. Thank you all very much for appearing.

STATEMENT OF

WILLIAM A. WHITESIDE, EXECUTIVE DIRECTOR

NEIGHBORHOOD REINVESTMENT CORPORATION

We appreciate this opportunity to share with the Committee our progress to date in assisting the NHS network in moving forward in serving over 180 communities throughout the country and to highlight some of our more promising Neighborhood Preservation Projects which enhance and complement the efforts of local NHSs.

In my statement I cover the following areas:

- Fiscal Outlook 1983-1984
- Statutory Intent and Authority
- Neighborhood Housing Services -- Description and Objectives
- The Apartment Improvement Program
- Owner Built Housing
- Mutual Housing Association Demonstration
- Private Sector Funding to Respond to the NHS Needs of the 80's

INTRODUCTION

Over the past year, Neighborhood Housing Services (NHS) programs have shown a remarkable resilience in the recent economic climate and have been satisfactorily coping with reduced resources and tackling increasing neighborhood needs. Neighborhood Reinvestment's technical services, along with the financial development work of Neighborhood Housing Services of America have made a critical difference to NHS programs in coping with the threat of reduced contributions. The following table shows the growth and shift in sources of NHS operating budget support:

	1981	%	1982	%
Savings and Loans and Savings Banks	$3,206,449	33.35	$3,822,639	28.27
Commercial Banks	2,225,783	23.15	3,198,394	23.65
Insurance Companies	686,960	7.15	948,000	7.00
Credit Unions	28,140	.29	26,270	.19
Corporations, Utilities, and Other Private Sources	1,430,974	14.88	2,536,557	18.76
Local Government	2,036,557	21.18	2,992,864	22.13
TOTAL	$9,614,863	100.00	$13,524,724	100.00

As the table illustrates, contributions were increased in almost every category. The reduced proportion of thrift institution support was offset in the main by a growth in support by other corporations.

The redirection of Neighborhood Reinvestment's effort which helped NHS programs rise to the challenge was made largely at the cost of new program development. We believe we can now begin shifting some effort back in the direction of new program development.

Our request in FY 1984 for $15,512,000 is the same amount that was appropriated in FY 1983. In our All Sources Budget, however, we project a reduction of $1.8 million. This results from reductions in non-appropriated resources, including interest earnings, local receipts related to NHS development and support from the entities represented on our Board of Directors.

The Federal Home Loan Banks found it necessary to reduce their support for the "agency" portion of our budget from the requested $1.6 million to $409,000 for FY 1983. Other entities on our Board contributed funds to partially offset this shortfall as follows: Federal Reserve Board, $400,000; FDIC, $200,000; Comptroller of the Currency, $200,000. The Board of Directors expressed their intention that this support should be a one-time transitional funding and that our FY 1984 budget submission request Federal funding to cover these expenses beginning in FY 1984. The Office of Management and Budget, however, was not able to recommend additional funding to cover this shortfall.

NEIGHBORHOOD REINVESTMENT CORPORATION ACT

After beginning our work as an office of the Federal Home Loan Bank Board, and four years of operation under the Urban Reinvestment Task Force (a task force made up of the Chairman of the Federal Home Loan Bank Board, the Secretary of HUD, a member of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Deposit Insurance Corporation, and the Comptroller of the Currency), the Neighborhood Reinvestment Corporation Act established the Corporation to implement and expand the demonstration activities of the Urban Reinvestment Task Force. These activities included establishing Neighborhood Housing Services (NHS) programs in neighborhoods throughout the United States, monitoring their progress and providing them with grants and technical services. In addition, the Corporation was directed to continue the work of the Task Force in identifying and assisting selected Neighborhood Preservation Projects offering promise as mechanisms for reversing neighborhood decline and improving the quality of neighborhood life, and to bring such successful projects to neighborhoods throughout the United States. The Corporation was directed to continue supporting Neighborhood Housing Services of America, including providing technical assistance and grants to expand its capacity to purchase NHS revolving loan fund loans and to contract with Neighborhood Housing Services of America for services which it can perform more efficiently or effectively than the Corporation.

NEIGHBORHOOD HOUSING SERVICES

Neighborhood Housing Services programs are state-chartered, nonprofit corporations governed by boards of directors representing a partnership of neighborhood residents, local business leaders and local government, with the objective of revitalizing declining neighborhoods. The programs' operating budgets are funded by voluntary contributions, primarily from local businesses. Their revolving loan funds are capitalized by seed grants from the Neighborhood Reinvestment Corporation matched many times over by local governments, foundations and businesses. Each NHS operates in one or more neighborhoods with defined boundaries characterized by a housing stock showing evidence of deterioration and lack of maintenance, an inadequate degree of mortgage and home improvement activities, a substantial degree of homeownership, and an income mix in the neighborhood as low as resources will permit (i.e., the lower the family incomes and/or the higher the repair costs, the greater the resources needed for revolving loan funds and staffing). NHS neighborhoods average 2,500 dwelling units.

Each local NHS board of directors manages the affairs of its corporation. It is responsible for keeping in place the resources necessary to operate the

NHS program, including loan fund and operating budgets. The board is responsible for insuring proper financial management, designating target areas, reaching agreements with local government on appropriate code inspection services and public improvements, and designing creative strategies to accomplish particular neighborhood objectives. The NHS staff implements policies of the board of directors, providing neighborhood residents with the following services: financial counseling, referrals to financial institutions for mortgage and home improvement loans, rehabilitation counseling and construction monitoring, and access to the NHS administered revolving loan fund established to meet the needs of unbankable NHS clients and to stimulate improvements which will promote neighborhood confidence. NHS programs coordinate their work with local government housing inspections which are aimed at achieving voluntary compliance with generally accepted health and safety standards.

Each NHS concentrates on improving the quality of life for neighborhood residents. They are not merely lending programs. NHSs secure public and private resources for capital improvements and improving vacant dwelling units, commercial and multi-family structures, etc. The board of directors continuously evaluates NHS progress toward stabilizing the neighborhoods and may add new program components or expand services to additional areas.

The role of the Neighborhood Reinvestment Corporation in relation to NHSs is to develop the partnerships which form their heart, and to provide training, technical services, and assistance in implementing revitalization mechanisms and strategies.

Neighborhood Housing Services programs are now serving 182 neighborhoods in 132 cities throughout the United States. Development is underway on ten neighborhood programs in additional cities, and existing NHS programs are being given assistance in expanding to a further ten neighborhoods. We are particularly encouraged that in two dozen of these 182 neighborhoods, the NHS' primary goals have been accomplished and work is underway to establish ways of providing residual services which will help keep these neighborhoods up to a good standard of continuing maintenance, and to move the main thrust of the program into additional (usually more difficult) neighborhoods.

As a result of Neighborhood Reinvestment's research and development efforts, which begin with the identification of promising Neighborhood Preservation Projects, over 40 neighborhood preservation mechanisms and strategies have been instituted in communities throughout the United States. An additional 30 such complementary programs are in development. Three types of complementary programs are particularly worthy of note: the Apartment Improvement Program, the Owner-Built Housing program and the Mutual Housing Association demonstration.

APARTMENT IMPROVEMENT PROGRAM

The Apartment Improvement Program is based upon a partnership of property owners and managers, tenants, financial institutions, and the city. The objectives of each AIP are to revitalize neighborhoods for the benefit of current residents with particular emphasis on privately-owned apartment buildings. Through the use of a computerized Real Estate Investment Analysis Model a financial analysis of the current and projected operations of each selected building is studied. An individually tailored improvement plan is developed for each building, including such activities as tenant participation, contemporary tax assessment reviews, repair and modernization, and increased investment or restructured mortgages to improve the economic viability of the buildings and to finance improvements. Developed in Yonkers, New York, the Apartment Improvement Program in its first 36 months was able to "turn around" sixty-five apartment buildings containing 3,500 units. The Apartment Improvement Program is now operating in 11 communities and additional programs are in development in eight communities. After having been considerably slowed during the past two years because of high interest rates, the Apartment Improvement Program is developing increased momentum with many rehabilitation packages becoming feasible at today's rates.

In FY 1982, AIP programs secured financing for 1,843 units totaling $15,400,000. In the first three months of FY 1983, financing commitments total $17,000,000 for 1,473 units.

OWNER BUILT HOUSING

The Owner Built Housing program addresses the need for affordable, quality housing for moderate income families. Based on a rural self-help model, this new program enlarges homeownership opportunity in NHS neighborhoods by enabling families collectively to build their own homes, with supervision, coordination, and technical assistance provided by the NHS. The initial demonstration project in the NHS neighborhood in Oakland, California was developed in 1980. It consisted of 14 families who invested 40 hours of work per week per family for a period of nearly a year. This investment of energy has enabled each family to take title to a conventionally-financed home with an estimated market value of over $85,000 by assuming a $43,000 mortgage.

The completion of ten units of Owner Built Housing in Hartford, Connecticut this month demonstrated that this construction method is feasible for two story homes constructed with basements, and that with careful timing the activity can be carried out in climatic zones subject to severe winter weather. Encouraged by this, we have undertaken an Owner Built development in Anchorge, Alaska among five programs to get underway during Fiscal Year 1983.

MUTUAL HOUSING ASSOCIATION

In the Housing Act of 1980, we were encouraged to undertake a national demonstration of Mutual Housing Associations. Although no additional funding was provided for this, we have been able to do the initial organizational work for a Mutual Housing Association in Baltimore, Maryland, and are in discussion with several communities regarding additional demonstration sites. Based upon a highly effective Western European model, the Mutual Housing Association demonstration is designed to create prototypes of publicly accountable, competent, private nonprofit organizations committed to continued annual production of new and rehabilitated housing at costs affordable to families and individuals of below-median income typical of NHS neighborhoods.

The Mutual Housing Association does not provide ownership -- it is not a condominium or co-op -- it is "a step-up from rental." It provides occupants with a voice in management, the opportunity for lifetime occupancy, and the potential for occupancy by future generations. They pay a share of the cost through a one-time membership fee (which earns nominal interest and is returnable), but have no equity interest.

The Mutual Housing Association demonstration also includes a model system of financing. It is designed to test a flexible, nonbureaucratic, cost-effective way for the production, maintenance and management of housing for lower income families. The financing mechanism is based on a front-end capital grant and membership fees combined with a small conventional mortgage. The rent calculation for each complex of homes includes a mutual capital charge which provides a source of capital for future development and provision for major replacement and modernization needs. Since the ownership vests in the association rather than the occupants, refinancing provides a further source of self-generated capital to the association.

The advantages of the capital grant system include: 1) flexibility (as interest rates change, the proportion of grant to mortgage changes to maintain a given rent level); 2) a one-time direct subsidy that is certain and does not inflate; and 3) a congruency of goals of developer, consumer and grantor.

The advantages of the tenure and governance system include neighborhood input into the level of maintenance, a balance between occupant interest and community interest in management decisions and, perhaps most important, a congruence of interest between "landlord" and "tenant" (the lack of this congruence has been perhaps the most glaring failure in America's past assisted housing efforts).

The organizational development in Baltimore has gone splendidly. The NHS partnership provided initial leadership which has since been supplemented by a committed group of Mutual Housing Association members waiting to occupy units which have been planned. The Association has incorporated as a Maryland non-profit corporation, and has elected a 25-member governing Board representing a carefully balanced partnership. The Board consists of nine resident members, four waiting members (pre-residents waiting to move into mutual homes), four neighborhood representatives, two city-wide at-large community representatives with housing interests, four financial community and business representatives and two City government representatives.

We undertook to raise the funding for the Baltimore capital grants from foundations, and have encountered very slow going on this. I have been raising money from foundations for the past 25 years and I have never seen them stretched as thin as they are today, attempting to meet social needs. The concept of Mutual Housing is interesting to them and many have said they would be willing to participate in funding in a demonstration in their own community, but only a very few have expressed interest in the Baltimore pilot. We are handicapped in this as compared to attracting private funds to Neighborhood Housing Services and complementary programs, since we are unable to provide a challenge grant or match to local funding.

In any case, the Baltimore Mutual Housing Association is planning to begin work on the first 16 units this spring with the assistance of the City of Baltimore, the State of Maryland, two or three foundations and corporations, and Neighborhood Reinvestment. Our ability to begin one or more additional demonstrations and the ability of the Mutual Housing Association of Baltimore to build out the planned 120 units in Baltimore depends upon the availability of governmental and foundation resources.

PRIVATE SECTOR FUNDING

Fund raising has been a significant challenge for NHS programs during the past year. It is a challenge which has been met, however, and NHS programs have remained strong and viable organizations during very difficult economic conditions. We have undertaken to assist NHSs in several ways in meeting the critical fund raising needs. We have provided grants to Neighborhood Housing Services of America for the following kinds of financial development work:

1. Local fund raising assessments to determine the potential for NHS fund raising and as preliminary information necessary to design effective fund raising approaches and training.

2. Fund raising training seminars for NHS and Neighborhood Reinvestment staff.

3. Fund raising counseling to NHS programs toward individual fund raising goals.

4. Hands-on management of local, regional and state-wide NHS fund raising campaigns.

5. Application to The Advertising Council, Inc. for a business press campaign to familiarize corporate America with NHS.

6. Securing below-market social investment commitments to purchase NHSA Notes for the NHS secondary market.

7. Preparation for a corporate campaign to raise the contribution dollars which will be needed to fund the difference between the interest rate on NHS loans and the below-market social investment rate on the NHSA Notes for the NHS secondary market, plus funds to continue the local NHS fund raising assistance.

With the aid of the training and materials provided by NHSA, Neighborhood Reinvestment's staff has been successful in counseling many NHS programs in expanding their base of operating budget support to include more corporate contributors and to offset reduced thrift institution support. In addition to this, NHSA has provided direct assistance to a number of NHS programs by managing fund raising campaigns to support the local operating budgets and has achieved successful results. (Over 400 corporations are now supporting NHS operating budgets.) Considerable progress has been made in the development of NHSA's capacity to keep pace with NHS secondary market needs with a primary reliance on private, rather than Neighborhood Reinvestment, resources.

Successful application to The Advertising Council, Inc. for a national public service advertising campaign promises to create a climate for continuing achievement of NHS private sector support goals in Fiscal Year 1983 and beyond.

UNITED STATES GENERAL ACCOUNTING OFFICE
Washington, D.C. 20548

FOR RELEASE ON
WEDNESDAY, MARCH 9, 1983

STATEMENT FOR THE RECORD BY
J. DEXTER PEACH, DIRECTOR
RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
ON

GENERAL ACCOUNTING OFFICE VIEWS ON STATES' EARLY IMPLEMENTATION OF THE SMALL CITIES COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM

This statement is being provided to assist the Subcommittee as it considers reauthorization of the Community Development Block Grant Program. It addresses preliminary results of work performed on the progress seven States have made in implementing the Small Cities Program as authorized by the Omnibus Budget Reconciliation Act of 1981.

The 1981 act made changes to the Small Cities Program that not only authorized a State-administered program but allowed a great deal of flexibility to the States in designing their program and method(s) for distributing the funds to meet local community development needs. The act emphasizes public participation to enhance public accountability and facilitate input from different levels of government.

The States we visited are making good progress in taking over the administration of the Small Cities Program and their actions to date are consistent with the 1981 changes. For example, our work showed

--States used a variety of methods to obtain input into the design of their Small Cities Program and to meet their public participation certifications to the Department of Housing and Urban Development (HUD). Also, citizen input played an important role in determining local community development needs.

--States used different methods for distributing funds and selecting grantees--eligible small cities and counties--but did so primarily on a competitive basis and in accordance with their statement of objectives provided to HUD and the criteria established for that purpose.

--States funded activities in 1982 that reflected their objectives and/or priorities. Most State-administered programs we reviewed differed from the previous HUD-administered program in that the amount of housing rehabilitation funded decreased and either public facilities or economic development activities increased. The percent of low- and moderate-income persons reported to be benefiting from the State-administered program also was less in six of seven States.

--Grantees and unsuccessful applicants generally viewed the State-administered programs favorably. When asked to compare the State program's award process, ability to meet local needs, flexibility in determining population groups to serve, and assistance to local communities with the past HUD program, both grantees and unsuccessful applicants rated the State program as being equivalent or better.

SMALL CITIES--SCOPE OF WORK PERFORMED

We performed our work in seven States: Alabama, Delaware, Iowa, Kentucky, Massachusetts, Michigan, and Utah. These seven States were selected primarily based on the progress they had made in implementing the Small Cities Program and to obtain geographic balance. When we conducted our field work--December 1, 1982, through January 15, 1983--most States were in the early stages of implementing the Small Cities Program. While essentially all had selected their 1982 recipients, all but one had not started monitoring and some were just completing the grant agreements with the local communities. Accordingly, our work was directed toward reviewing the State decisionmaking process through the selection of recipients.

We also sent questionnaires to a statistical sample of 209 of 449 successful (grantees) and 245 of 1,150 unsuccessful applicants in the States to obtain perceptions from the local communities on the State-administered program. Our samples enabled us to make estimates at the 95 percent confidence level projectable to the population universes. An attachment to this statement provides a summary of the more significant questionnaire responses on (1) communication between States and local communities, (2) local community planning, (3) the State grant award process, and (4) a comparison of the HUD- and State-administered programs.

STATE COMPLIED WITH PUBLIC PARTICIPATION REQUIREMENTS

We found that the seven States reviewed complied with the public participation requirements contained in Title III of the Omnibus Budget Reconciliation Act of 1981. The act requires each State to certify, among other things, that it:

(1) furnished citizens information about the amount of funds available for proposed community development and housing activities, and the range of activities that may be undertaken;

(2) allowed affected citizens or, as appropriate, units of local government, the opportunity to examine and comment on proposed statements of community development objectives and projected use of funds, including how the State will distribute funds to local government units;

(3) held at least one public hearing to obtain the views of citizens on community development and housing needs; and

(4) made the final statement available to the public.

The States used a variety of methods to comply with the public participation certification. A common method used to distribute program information and to solicit comments from interested parties was the mail. To help assure that program information was widely disseminated and that citizens were made aware of their opportunity to comment on the State's proposed program, some States also had regional planning agencies distribute program information. Some States also periodically published and distributed newsletters throughout the State to provide current information about the program and its design. Direct contacts by State officials, newspapers and radio were also used to inform the public about the program.

Also, all States held at least one public hearing to obtain views and comments on the program. Some States held more. Utah, for example, held 12 such meetings, Michigan 6, and Iowa 5. Alabama, Delaware, Kentucky, Massachusetts, and Michigan also held workshops to explain the State program to interested parties.

In response to our questionnaires, 77 percent of the grantees and 57 percent of the unsuccessful applicants told us that the State asked for their suggestions on how to formulate and carry out the Small Cities Program. Sixty-five percent of the grantees and 52 percent of the unsuccessful applicants who said they were asked to provide suggestions did so. Sixty-nine percent of the grantees and 64 percent of the unsuccessful applicants said that the communication that took place between the State and the local community prior to implementing the Small Cities Program was adequate.

Citizen input also played an important role in determining local community development needs. Almost all grantees in the seven States utilized individuals and groups that were not part of the local government to help identify community development needs. Also, 80 percent of the grantees conducted a formal needs assessment prior to submitting their applications for Small City Program funds.

For example, eighty-eight percent of the successful applicants said that they used input from participants that were not part of the community government in developing plans for carrying out projects and activities under the Small Cities Program. Forty-one percent of the grantees said that individual citizens participated in the determination of its community development needs, and 27 percent also cited citizen groups' involvement. Others cited frequently as helping to determine local needs were consultants or contractors (42 percent), council of governments (39 percent), regional advisory councils (25 percent), and county officials (23 percent). Fifty-six percent of the grantees stated that input into the local decisionmaking process from these citizens and groups was obtained through public hearings; 61 percent also said input was obtained through meetings open to the public.

Eighty percent of the grantees also said that in order to help identify local community development needs they conducted a formal assessment of such needs prior to submitting their grant applications to the State for funding. Fifty-six percent of the grantees said that the community government conducted the needs assessment, 29 percent said that it was performed by a consultant or contractor, and 8 percent cited the county government.

STATES ADHERED TO THEIR FUNDING OBJECTIVES AND SELECTION CRITERIA

Our review of a statistical sample of the successful and unsuccessful applicants for Small Cities Program funds showed that all seven States selected projects for funding that were in accordance with the statements of objectives and proposed use of funds they provided HUD. We also found that all seven States generally followed their established selection criteria. State methods for distributing funds varied and the States developed a number of different approaches to select specific projects for funding, most of which were on a competitive basis.

For example, we found that five of the seven States, in accordance with the program design they provided HUD, divided Small Cities Program funds among various funding categories prior to determining specific projects to be funded as follows.

--Two States (Kentucky and Michigan) distributed their funds to reflect their priorities for funding specific type projects. Project areas emphasized were economic development, housing rehabilitation and public works.

--Utah allocated its funds among seven planning districts and distributed an equal amount to each district plus an additional amount per each individual in the district.

--Iowa allocated 35 percent of its funds to smaller cities and 65 percent of its funds to larger cities.

--Alabama established categories for specific project funding, and also provided separate allotments for counties, larger cities, and smaller cities.

Four of the seven States--Delaware, Iowa, Massachusetts, and Utah--used a competitive selection process to determine the individual projects to be funded. Basically, all utilized a panel to rank and select the applications to be funded. The remaining three States--Alabama, Kentucky, and Michigan--determined projects to be funded through both a competitive and noncompetitive process depending on the project type. Kentucky, for example, used a competitive ranking system to select applications for housing and public facility projects. It used a noncompetitive process for economic development projects in that State staff and a panel of economic development experts reviewed the applications to determine if they met established criteria.

COMPARISON BETWEEN HUD AND STATE-FUNDED ACTIVITIES AND POPULATION TARGETED

All seven States funded activities in 1982 that reflected their objectives and/or priorities. In five of the seven States, the State-administered program differed from the previous HUD-administered program in that the amount of housing rehabilitation funded decreased. As a percentage of the total funds awarded, the decreases ranged from 15 percent in Utah to 33 percent in Iowa. In three of the five States (Alabama, Iowa, and Utah) there was a shift from housing rehabilitation to public facilities. In the other two States (Kentucky and Michigan) there was a shift from housing rehabilitation to economic development.

In six of the seven States the program administered by HUD and the State also differed in that under the State program the percent of low- and moderate-income persons reported as being targeted for benefits was less. For example,

--Massachusetts went down 6 percent (from 90 to 84).

--Utah went down 12 percent (from 71 to 59).

--Alabama went down 13 percent (from 95 to 82).

--Kentucky went down 13 percent (from 85 to 72).

--Iowa went down 15 percent (from 91 to 76).

--Michigan went down 19 percent (from 91 to 72).

In Delaware the percent of low- and moderate-income persons reported as being targeted under the State program went up 1 percent from 94 to 95.

The decreases are not unexpected given the shift in funding from housing activities which can be more easily targeted to specific groups and/or individuals than economic development or public facilities projects that benefit a particular geographic area.

In two of the States the lower income benefit data reported on some projects were minimum numbers. For example, in Kentucky some of the grantees requesting funds for economic development projects stated only that at least 51 percent of those benefiting would be low- and moderate-income persons. Also, in two other States data on benefits to low- and moderate-income persons was not provided or was incomplete; therefore we could not include it in our overall computations for the State. In Michigan out of 88 grantee applications, such data was not provided on 19 applications. In Utah data was not provided on 8 and was incomplete on 26 others.

It should also be noted that the data used to compare the State and HUD programs was taken from grantee's applications on how cities planned to spend their block grant funds rather than how they actually spent the money. While reporting requirements had yet to be finalized in the States we visited, most anticipate including actual benefit data. We believe actual benefit data, to the extent possible, should be used in measuring benefits to lower income persons from block grant assistance. We addressed this issue recently in our report "HUD Needs To Better Determine Extent Of Community Block Grants' Lower Income Benefits" issued November 3, 1982, and in our testimony before the House Subcommittee on Housing and Community Development on December 7, 1982.

VIEWS OF GRANTEES AND UNSUCCESSFUL APPLICANTS

Grantees and unsuccessful applicants in the seven States we visited generally viewed the State-administered Small Cities Program favorably. For example,

--A majority of both grantees (85 percent) and unsuccessful applicants (52 percent) familiar with the State's method used to select grantees, labeled the process as fair.

--Ninty-one percent of the grantees and 66 percent of the unsuccessful applicants believed that the projects and activities encouraged by their State program were adequate or more than adequate to address the development needs of their communities.

--Of the grantees and unsuccessful applicants (66 percent and 44 percent respectively) receiving application assistance from States, most rated the assistance as helpful or better.

Sixty percent of the grantees and 61 percent of the unsuccessful applicants said they had participated in the HUD Small Cities Program. When asked to compare specific aspects of the State program with the past HUD program these applicants generally rated the State program as being equivalent or better. For example,

--Sixty-six percent of the grantees and 56 percent of the unsuccessful applicants said State application procedures were less or much less burdensome than HUD's.

--Seventy-nine percent of the grantees and 78 percent of the unsuccessful applicants said the State program allowed the same or wider variety of projects and activities than could be funded under the HUD program.

- --Ninty percent of the grantees and 83 percent of the unsuccessful applicants said the State program allowed communities equal or more flexibility than HUD's program in determining population groups to serve.
- --Eighty-five percent of the grantees and 82 percent of the unsuccessful applicants said that the emphasis or order of the State's priorities is equal to or more consistent with the community's priority of development needs than under the HUD-administered program.
- --Eighty-four percent of the grantees and 71 percent of the unsuccessful applicants said that the State method for granting awards was equal to or fairer than the method used by HUD.
- --Seventy-eight percent of the grantees said that the State's technical assistance was equally as helpful or more helpful than the technical assistance provided by HUD.

* * * *

In summary, all of the seven States we visited solicited and obtained comments from citizens, local governments, and other affected parties in designing their Small Cities Program, and complied with the public participation certifications they made to HUD. All seven generally adhered to their funding distribution objectives and selection criteria. Most State-administered programs differed from the previous HUD-administered program in that the amount of housing rehabilitation funded decreased and either public facilities or economic development activities increased. The percent of low- and moderate-income persons reported to benefit from the State-administered program also was less in six of seven States. Both grantees and unsuccessful applicants generally viewed the seven State-administered programs favorably, stating, among other things, that the selection process, the ability to meet local needs, the flexibility in determining population groups to serve, and the assistance to local communities were equivalent or better than the HUD-administered program.

GRANTEES AND UNSUCCESSFUL APPLICANTS VIEWS ON STATE PROGRAM

We sent questionnaires to a statistical sample of both the successful (grantees) and unsuccessful applicant universes in each of the seven States we visited to obtain perceptions from the local communities on the State-administered program. Our samples enable us to make estimates at the 95 percent confidence level projectable to the population universes. The results presented below represent responses weighted to reflect the responses of the population sampled. The range of response rates in the seven States for the successful applicants was from 76 to 100 percent. The range of response rates in the seven States for the unsuccessful applicants was from 62 to 100 percent. The aggregate response rate for the successful and unsuccessful applicants was 90 and 84 percent respectively.

The successful applicant questionnaire was designed to obtain information on the local community's input into the State decisionmaking process in designing its program, the way in which the community planned for, applied for, and is using the funding it received, and the community government's views on the way in which the State conducted the program compared with the past HUD-administered program. We asked that the views expressed be those of the highest level government official familiar with the community's experience under the program.

The unsuccessful applicant questionnaire was also designed to obtain information on the local community's input into the State's decisionmaking process in designing its program, the way in which the community applied for funds, and the community government's views on the way in which the State conducted the program compared to the past HUD-administered program. We also asked unsuccessful applicants questions concerning the State's decision not to fund their projects. As in the successful applicant questionnaire, we asked the views expressed be those of the highest level government official familiar with the community's experience under the program.

I. COMMUNICATION BETWEEN STATE AND LOCAL COMMUNITIES	Grantee percent	Unsuccessful applicant percent
State informed community of intention to have small cities program		
Yes	97	92
No	3	8
Method by which State provided information (Respondents could check more than one item)		
Meetings	75	70
Mailing	89	79
Individual communications	35	25
Other	22	13
State requested community's suggestions on how to formulate the program		
Yes	77	57
No	23	43
State requested community's suggestions on program regulations		
Yes	78	63
No	22	37
Adequacy of communication between the State and community prior to implementing the program 1/		
Much more communication than adequate	5	1
More communication than adequate	14	8
About an adequate amount of communication	69	64
Less communication than adequate	7	14
Much less communication than adequate	1	4

1/In the following cases where the responses do not add up to 100 percent the respondents said they had no basis to judge.

II. COMMUNITY PLANNING

Personnel outside the local government participating in community development planning

	Grantee percent
Yes	88
No	12

Personnel outside the local government who participated in community development planning
(Respondents could check more than one item)

Individual citizens	41%	Citizen groups	27%
Consultants or contractors	42%	County officials	23%
Regional advisory council	25%	Council of governments	39%
Associations	6%	Other parties	15%

Means by which citizens participated in local decisionmaking process
(Respondents could check more than one item)

Individual visits, telephone calls or letters to community government officials	39
Meetings open to the public	61
Public hearings held by the community's government	56
A formal program of submitting proposals for suggested projects and activities	9
Other	11

Formal community needs assessment conducted prior to application

Yes	80
No	20

Party that conducted needs assessment
(Respondents could check more than one item)

Community government	56
Consultant or contractor	29
County government	8
Other	26

III. STATE PROGRAM'S ASSISTANCE, AWARD PROCESS, AND ABILITY TO MEET LOCAL COMMUNITY DEVELOPMENT NEEDS	Grantee percent	Unsuccessful applicant percent
Applicants receiving State assistance in preparing application		
Yes	66	44
No	34	56
Helpfulness of State assistance in preparing application		
Very great help	27	17
Great help	46	30
Moderate help	15	27
Some help	11	19
Little or no help	1	7
Familiar with State's award process 2/		
Very familiar	36	15
Familiar	55	59
Unfamiliar	10	26
Responses on fairness of the award process from those familiar with the process		
Very fair	30	9
Fair	55	44
Neither fair/unfair	10	23
Unfair	5	21
Very unfair	-	4
Adequacy of State program to meet local needs		
Much more than adequate	9	4
More than adequate	25	12
Adequate	58	50
Less than adequate	5	24
Much less than adequate	1	3

2/Percentages of respondents will sometimes total more or less than 100 percent due to rounding.

IV. APPLICANTS' COMPARISON OF STATE PROGRAM WITH FORMER HUD PROGRAM 3/	Grantee percent	Unsuccessful applicant percent
Percent that participated in HUD's Small Cities Program		
Yes	60	61
No	40	39
Application procedures		
State procedures much more burdensome	2	4
State procedures more burdensome	5	5
State procedures about equally burdensome	27	35
State procedures less burdensome	47	42
State procedures much less burdensome	19	15
Eligibility requirements		
State requirements much more difficult	-	6
State requirements more difficult	5	7
State requirements about equally difficult	70	64
State requirements less difficult	20	23
State requirements much less difficult	5	-
Variety of projects or activities that can receive funding		
State allows much wider variety	4	3
State allows wider variety	27	25
State allows about same variety	47	51
State allows narrower variety	8	12
State allows much narrower variety	6	5

3/Responses to specific comparisons represent those who said they had participated in HUD program.

Flexibility in determining population group to serve	Grantee percent	Unsuccessful applicant percent
Much more flexibility in State program	7	3
More flexibility in State program	25	21
About equal flexibility in State program	58	60
Less flexibility in State program	2	7
Much less flexibility in State program	-	2
Consistency of program priorities with local community's development needs		
State priorities are much more consistent	8	1
State priorities are more consistent	28	19
State priorities are about equally consistent	49	62
State priorities are less consistent	5	9
State priorities are much less consistent	1	3
Fairness of the award process		
State method is much fairer	10	7
State method is fairer	25	8
State method is about equally fair	48	56
State method is less fair	5	15
State method is much less fair	3	8
State technical assistance		
State assistance is much more helpful	14	
State assistance is more helpful	34	
State assistance is about equally helpful	30	
State assistance is less helpful	11	
State assistance is much less helpful	3	

National Leased Housing Association
serving America's rental housing needs

1800 M STREET NW / SUITE 400 SOUTH / WASHINGTON D.C. 20036 / (202) 785-8888

STATEMENT OF THE NATIONAL LEASED HOUSING ASSOCIATION SUBMITTED TO THE HOUSING AND URBAN AFFAIRS SUBCOMMITTEE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

The National Leased Housing Association consists of 800 public and private organizations concerned with providing decent rental housing to low and moderate income Americans. With the demise of the Section 8 production program, a new rental housing initiative is vitally needed.

There is a desperate need for affordable rental housing in most sections of the country that just cannot be met by the private sector without assistance. In many areas, vacancy rates are below the desirable five percent level. As the economy improves, this situation will exacerbate as renters end the doubling up that has prevailed during the past few years. To meet the increasing need for rental units, the deep subsidy of Section 8 will not be necessary to get such housing built. What is needed is a shallow or partial subsidy to bridge the present affordability gap. Because of the limited nature of the subsidy, obviously the lowest income tenants cannot be fully served. However, to the extent that the total housing supply in a community is increased to meet demand, overall rents will be reduced to a more affordable level and thus make the Section 8 existing program more workable in the locality.

We commend the bi-partisan efforts of Senators Dodd and D'Amato directed toward developing the rental housing program in the bill reported by your Committee last year. However, now that the year's interval is permitting greater time to focus on the subject, we suggest as a model for your consideration the program originally set forth in a bill introduced by Senator Dodd last year. Under that program, developers, in conjunction with cities, would apply either to HUD or a state agency for the necessary assistance to get a rental project built. Such assistance can be flexible in amount and type, such as capital grants, loans, write downs, etc. The program could only operate in areas of rental need. This year, a similar program has been introduced by Representative Charles Schumer in the House, and is set forth in H.R.1. The National Leased Housing Association strongly endorses that effort.

We do have some concerns with this legislation, and suggest the following amendments.

1. We agree with the basic fund allocation mechanism set forth in the bill of either cities applying directly to HUD on a specific project [312(c)] or allowing HUD to delegate to state agencies the right to make project choice [312(e)]. Significant funding should be earmarked under both alternatives. It is essential that both the localities and the states must choose developers pursuant to nationally prescribed standards, the most vital being an open and objective competition.

However, Section 312 should be amended to provide that if a city does not endorse a project under 312(c), the developer would have the right to apply directly to HUD; in such event, HUD must solicit the comments of the city. This change is essential to provide housing in those communities that seek to bar low and moderate income rental housing. H.R.1, as drafted, gives these cities an absolute veto on applications.

2. The limitation on condominium conversion and the period of low income occupancy [317(a)(3)] should be reduced from 20 years to the longer of ten years, or half the length of the bonds financing the project or the assistance contract. This time period was adopted by Congress to govern the tax exempt financing of multifamily projects in the 1982 Tax Equity and Fiscal Responsibility Act. Such period is realistic in today's financial markets where a ten year multifamily loan has become common.

3. Assistance in the form of capital grants [312(d)(1)], at least to private developers, should be eliminated. Assistance should basically be in the form of repayable second mortgages. There is no justification to make grants when a sale or refinancing will produce cash to repay the funds advanced.

4. The provision in Section 319(a) that requires prevailing wage rates be paid to those involved in project operations should be dropped. We know of no other program which requires prevailing local wages be paid in project operation.

5. Under Section 317(c)(1), the tenant should not be limited to paying 25 (or 30) percent of his or her income for rent. Instead, 20 percent of the units should rent at no more than 30 percent of 80 percent of area median, thus assuring widely affordable rents. However, a tenant should be allowed to pay such percentage of income as he/she desires to obtain the unit at such

rent.

6. 317(a)(3) should make clear that the prohibited discrimination is that against a tenant because he (she) will be receiving Section 8 existing or voucher assistance in the project assisted under the program. As drafted, this section could prevent the rejection of tenants presently living in an assisted project, a proper action because such tenants are already living in decent housing.

The Administration's Bill

We have serious problems with many initiatives in the Administration's bill, primarily the ending of the Section 8 existing program, which is most workable, in favor of a housing payment certificate program, which is not, as well as the termination of the successful Section 515 program.

NLHA has over 300 local housing authority members who administer the Section 8 existing program, so we are naturally quite concerned with its future directions. By and large, we have been quite satisfied with the program as it is now structured, and we have seen no real need for the comprehensive changes proposed in this legislation. We do have the following specific comments, however, if changes are to be made:

1. We oppose the raise in the limit on tenant rent increases from 10 percent a year to 20 percent a year. Not only will this increase create an undue hardship for the tenant, but it will also add to the administrative burden as one more variable would need to be adjusted to calculate tenant rent contributions.

2. We have great concern with the new "payment standards" replacing the present Fair Market Rents. Our concern is directed to the adequacy of the amount of payment. We are particularly disturbed by the proposal that these payment standards not be published for public comment. There would be very little protection against the arbitrary imposition of low payment standards which would, in effect, gut the program unless the public had a change to comment and appeal. NLHA strongly opposes use of the 40th percentile in determining existing Section 8 FMRs and in calculating the new payment standards.

3. It should be made clear that as under the Section 8 existing program, payments should go directly from the housing authority to the landlord, and not to the tenant. This is the only practical way to assure that the landlord receives a rent payment.

4. We have no difficulty with the minimum rent provisions to the effect that the tenant must either pay ten percent of gross

income or the portion of any welfare assistance payments specifically designated to meet housing costs. However, in such event, the state should not be permitted to lower the amount of specifically designated housing payments, or else the tenant could be caught in a vicious circle of being cut by both HUD and the state welfare agency.

5. While we favor the change made from last year's proposal which would now allow adjustments (specifically increases) to be made in the amount of tenant assistance payments on an annual basis, we feel that to not provide any additional funds for increasing assistance payments places an undue burden on the PHA. Not only will this cause a PHA to artificailly restrict the number of households to be served by the program to ensure reserves, but would also require that any future inflation increases would have to be financed through cutbacks by the PHAs in the total number of assisted units.

6. The proposal would eliminate the sixty day period for the payment for vacant units. We have found this to be a very necessary provision to get landlords to enter the program; however, because of the real demand for Section 8 assistance, vacancies rarely occur and thus these payments are infrequently made. In other words, the sixty day vacancy provision provides pscyhological benefits to landlords without any real cost to the government.

7. We do not object to limiting assistance to families in 50% of median under this phase of the program. However, any applicant on a waiting list currently who is in the 50 percent to 80 percent of median category should be allowed to remain. If this is not done, there would be real hardships to those families who justifiably relied on the program, in addition to some real administrative problems for the local administering agency.

8. There is a conflict between extending the priority criteria to those families paying over 50 percent of their income for rent and the present priority for families living in substandard housing. It is the experience of many of our members that those paying over 50 percent of their income for housing are doing so voluntarily to get better housing. Should they be housed over those who are now living in substandard housing? This is a real question of equity.

Other Provisions

There are certain provisions in the Administration's bill which have a positive effect for rental housing, and we urge you to include them in any legislation which you enact:

(a) We favor in concept the rental rehabilitation program which the Administration is forwarding, assuming it is part of a comprehensive housing effort that includes new production and substantial rehabilitation. Indeed, your committee might wish to consider it as a substitute for the Section 8 moderate rehab program, which has proven to be most clumsy both in implementation and operation in any areas. However, we suggest the following programatic changes:

First, we question whether $5,000 is a sufficient amount to produce any meaningful rehabilitation. Second, unless the modified Section 8 certificate is attached to the unit, we doubt if any lenders would be interested in financing the project; the free floating certificate concept set forth in the bill just won't get units financed. Third, we think it extremely unwise to make the owner personally liable on the note, as this precludes equity syndication. The admnistration, in the Economic Recovery Tax Act of 1981, wisely encouraged investment in existing properties through 15 year write- offs and 200 percent declining balances. This has spurned much private sector interest in investing in this type of property because of the tax benefits which both Congress and the Administration wanted the owner to enjoy. Thus, it is ironic that the Administration, in its proposal here, would preclude the very sort of tax-oriented investment which last year's tax bill encouraged.

(b) We also endorse the provision in the Administration's bill making the construction of new housing eligible for funding under the CDBG program as a reasonable measure directed toward assisting housing production. Obviously, the need for such provision would be less if a program similar to that contained in H.R.1 is adopted.

(c) The following provisions in the Administration's bill aid in the financing of multifamily housing, and we urge their inclusion in any bill that you report:

1. A very salutary proposal is the removal of the language in Section 207 mandating that the Secretary regulate project rents, coupled with the Administration's intent to de-regulate project rent levels on unsubsidized projects. We totally agree with the rationale that such de-regulation would give a needed boost to the hard-pressed rental housing industry and remove unnecessary federal regulation.

2. Another solid initiative in the bill would be to increase mortgage limits for substantial rehabilitation. Such a move would encourage substantial rehab of multifamily units by making it economically viable for the owner to do so.

3. Another helpful provision of the Administration's bill is removing the 20% restriction on the mortgages that FHA can co-in-

sure. In the multifamily field, we believe that co-insurance could be a very useful tool to enable to lender to, in effect, buy freedom from arduous processing restrictions by willingness to assume part of the risk of the loan. With the small volume of multifamily mortgages, unless the 20% restriction is removed, the co-insurance program is in danger of becoming a nullity.

4. We favor the amendment to Section 245(c) to allow graduated mortgages for multifamily insured projects, and also the new Section 316(b) to allow shared appreciation mortgages for such rental efforts. Although the use of these new devices in in its infancy for multifamily housing programs, certainly the opportunity should exist to utilize such creative financing with FHA multifamily insurance.

There are two provisions in the Administration's bill which we strongly oppose.

First, the Administration would do away with the authority for Ginnie Mae special assistance functions or emergency house purchases under the Tandem plan. These programs have proven very useful programs in the past, and we see no justification for their repeal.

Second, under the Administration's bill, tax exempt financing would not be permitted when a mortgage is co-insured under Section 244. As before stressed, co-insurance is a very beneficial concept of risk sharing between the private sector and the federal government. We are at a loss to understand any policy justification for repeal of this useful authority.

We are very concerned with the statement that appears in the Administration's justification to the effect "the Department intends not to allow such arrangements with respect to its Co-insurance Programs." If the Administration is demonstrating an intent to achieve this end without legislation at the present time, then it is in violation of Section 817 of the Housing and Community Development Act of 1974, which precludes the denial of any federal housing assistance because of the use of tax exempt financing. We trust that this is not the Administration's intent, but hope they will give us further clarification.

Thank you for your consideration of these issues.

National Governors' Association

Scott M. Matheson
Governor of Utah
Chairman

Raymond C. Scheppach
Executive Director

TESTIMONY OF

THE HONORABLE CHRISTOPHER S. BOND
GOVERNOR OF MISSOURI

To

THE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
U.S. SENATE

Regarding

COMMUNITY DEVELOPMENT PROGRAMS

March 10, 1983

HALL OF THE STATES • 444 North Capitol Street • Washington, D.C. 20001 • (202) 624-5300

It is my privilege to testify before your committee on behalf of the National Governors' Association (NGA), as the Chairman of the NGA Committee on Community and Economic Development.

Summary

NGA supports the reauthorization of the State administered Community Development Block Grant Program in its present form while it would like to see a significant State role in the small cities Urban Development Action Grant Program which the Department of Housing and Urban Development is having difficulty administering.

Community Development Block Grant

In view of the current economic situation and the need to help our citizenry, the National Governors' Association wholeheartedly supports the reauthorization of the Community Development Block Grant (CDBG) Program in its present form. This program assists in the "development of viable urban communities, by providing decent housing and suitable living environment and expanding economic opportunities, principally for persons of low and moderate income."

As States we are particularly pleased to call for the reauthorization of the CDBG Program because for the first time the States are active participants. In 1981, amendments to the Housing and Community Development Act of 1974, as amended, provided States with the opportunity to administer the non-entitlement small cities CDBG Program. In FY 1982, 36 States and Puerto Rico consulted with local officials, developed objective selection criteria, and awarded nearly $750 million in State administered CDBG funds to nearly 1,600 communities under 50,000 population. Projects funded under the program included repairing public facilities, creating jobs through economic development projects, providing decent housing and a suitable living environment, and expanding economic opportunities.

In the State of Missouri, we recently awarded $12.7 million in housing and public facility CDBG funds for 67 projects in 61 small cities and counties throughout the State. More than 500 Missouri communities submitted housing and public facility applications requesting in excess of $97 million. In Missouri, where unemployment is over 10%, the State awarded $4.5 million to 13 communities for economic development projects. These 13 projects will create or retain approximately 1,570 jobs in the State.

Because of the new State role in the CDBG Program, it is appropriate to review the accomplishments of the first year of State administration. For sound reasons, the program appears to be off to a successful start. The following seem to be contributing factors for its success. The appropriation level for the program remained the same as in previous years. Transitional funds were available through the HUD 107 Technical Assistance Program to help States gear up for the CDBG program's design and implementation. And the legislation and regulations were flexible enough to allow States to design their programs to meet local needs and objectives. After a year of administering the program, States have reached many of the goals which were articulated during the legislative debate over the State CDBG program in 1981.

State officials have worked very closely with local officials in designing the State CDBG Program. Although the 1981 amendments require States to furnish information to local governments regarding the design of the program, State administering agencies have gone well beyond this requirement. Approximately eight States distributed an extensive survey to every eligible community soliciting their advice on how the money should be distributed. Nearly all States have formally established locally-oriented policy advisory committees to help design the States' selection systems. Some States have even supplemented these committees with technical advisory committees composed of local CDBG practitioners. In the State of Washington, State program representatives visited over 100 communities to explain the new program. Examples of State-local cooperation are plentiful.

More local governments are participating in the CDBG Program than ever before. The high degree of State-local cooperation, coupled with the drastic need for federal funds, have led to greater participation by local governments in the State CDBG Program. The increase in the number of grant applications between the HUD-administered Small Cities CDBG Program in 1981 and the state-administered program in 1982 has been phenomenal. Iowa saw an increase from 175 applications in 1981 to 373 applications in 1982. Georgia received 141 additional applications in 1982. In 1982, Kentucky, Nebraska, North Dakota, Tennessee, Wisconsin and Wyoming received twice as many as HUD received during the previous year. Local officials in Delaware and Nevada submitted almost three times as many applications in 1982 as in the previous year.

States have been more sensitive to the nature of local problems and needs. The flexibility of the CDBG Program has allowed States to design their programs to meet the needs of their local units of government. For example, with unemployment ranging between 10-15% in many parts of the country, some States have focused on job creation activities. Approximately 10 States have established economic development set-asides or mini-UDAG programs where local officials can apply for funds at any time during the year. For example, the Commonwealth of Kentucky used $3.6 million in their economic development set-asides to fund 14 projects totalling $98 million. This is a leveraging ratio of nearly 28 to 1. These projects created or retained nearly 1,436 jobs. Some States have targetted their funds to public facilities projects, while others have focused on housing related activities.

States have been able to package CDBG funds with other State, federal, and private resources. To encourage private sector involvement, many States included a leveraging factor in their selection systems. Therefore, communities were rewarded for packaging CDBG with other resources. Other States actively coordinated State-appropriated funds with CDBG dollars. In Michigan, local applicants are encourage to link CDBG funds with the Mighigan State Housing Development Authority's Neighborhood Improvement Program. The Connecticut Department of Housing contributed nearly $600,000 from State appropriated housing funds to local CDBG recipients in 1982. In the State of Washington, State community facilities funds are being used in conjunction with CDBG dollars. Similar joint funding is also being used in a number of other States.

With the new State administered Job Training Partnership Act funds, the

Community Services Block Grant Program and other federal development programs, States are in a prime position to coordinate and target CDBG resources.

The State CDBG Program can be used in conjunction with State development plans. In 1981, many States stressed that CDBG funds could be directed tocommunities in line with broad State economic development goals and objectives. They felt that the State had a better understanding of statewide community and economic development goals and could use the CDBG funds in conjunction with them. For example, Alabama has successfully targetted a portion of its economic development set-aside to four rural and impoverished counties in the western part of the State. Idaho has targetted some of its CDBG funds for community facilities projects in northern Idaho to encourage the diversification of its economy from lumber to other sources of income.

The States are beginning to meet the needs of smaller communities which never participated in the CDBG Program. For example, in the FY 1982 program, Iowa, Alabama, and North Dakota set up special competitions for communities of less than 10,000 population. Under the State-administered program it appears that more smaller communities under 10,000 population were funded than ever before.

The States are meeting the statutory purposes of the Act. NGA reaffirms its support for the program's three board national objectives, i.e. a) to benefit low and moderate income families; b) to aid in the prevention or elimination of slums orblight; and c) to meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health and welfare of the community. NGA supports the maintenance of the present statutory language absent a showing that the three broad goals are not being met. Additional language will only reduce flexibility, increase red-tape and increase state administrative costs. NGA opposes measuring the meeting of the statutory objectives on a project-by-project basis. While it is possible to measure the specific low and moderate income benefits of housing programs, it is particularly difficult to measure that benefit in community development and economic development projects.

Urban Development Action Grant Program

Section 119 of the Housing and Community Develoment Act establishes the Urban Development Action Grant (UDAG) Program. The UDAG Program is a competitive grant program designed to create jobs and increase the tax base in distressed cities and urban counties. The UDAG Program is a useful tool in the federal economic development arsenal.

The Administration's FY 1984 budget proposal of $196 million for UDAG is a significant reduction from the $440 million in FY 1983. Under the Administration's proposal, unobligated UDAG funds from previous years will be deferred in the amount of $244 million to be carried over to FY 1984, to fund the program in that year at $440 million. It appears the 51% of the $244 million, or $126 million, is carried over from the small cities portion of the Program. NGA registers its concern over the lack of participation in the program by small communities of less than 50,000 population.

NGA recommends that Congress consider a greater role for States in the small cities portion of the UDAG Program. We are prepared to work with this

Committee and HUD to examine ways in which States can increase local participation. This might include providing training to State personnel in the UDAG Program to facilitate the State transfer to local government officials of UDAG application and packaging techniques, providing additional funds to States under the State 107 Technical Assistance Program to increase the resources available for State assistance to small localities, or transferring and transforming the small cities categorical UDAG Program into the small cities CDBG Program. We feel that States can transfer their successful experiences with the small cities CDBG Program to the small cities portion of the UDAG Program.

On behalf of the NGA, The States look forward to working with the Administration and Congress on the reauthorization of the Housing and Community Development Act.

Mr. Chairman, If you have any questions, NGA would be happy to respond in oral testimony at a later date or in written form.

April 8, 1983

Chairman John Tower
Subcommittee on Housing & Urban
Affairs
United States Senate
522 Dirksen Building
Washington, D.C. 20510

Dear Senator Tower:

Thank you for the opportunity to present our written statement for your hearing held on March 10, 1983. As president of Banco Mortgage Company, I am particularly pleased to submit our views at this time on an issue of great importance to us.

It is our understanding that one of the issues being addressed is whether to raise the conventional residential mortgage loan ceiling for the Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") above the $108,300 limit currently imposed by statute. This issue is critically important to Banco Mortgage and its subsidiary, Residential Funding Corporation ("Residential Funding") and perhaps to the survival of a private secondary mortgage market. To begin with let me give you some background on the company.

Background

Banco Mortgage was founded as Iowa Securities Company in 1906 in Waterloo, Iowa. Banco Mortgage originates, markets and services primarily residential first mortgage loans.

In 1969 Banco Mortgage was acquired by Northwest Bancorporation as a wholly owned subsidiary. Under Northwest Bancorporation, Banco Mortgage has grown to become the third largest mortgage banking firm in the country servicing $8.3 billion in mortgage loans. The parent company is a $17.6 billion banking and diversified financial services company with 86 banks in 7 states, 5 trust companies and 6 additional financial services companies with offices in more than 40 states.

In November 1982, Banco Mortgage, with Salomon Brothers an investment banker and Mortgage Guaranty Insurance Corporation (MGIC) a private mortgage insurer, introduced a program through a new Banco Mortgage subsidiary, Residential Funding. Its goal is to provide a needed service to the residential mortgage lending institutions in this country, primarily savings & loan associations, commercial banks, mutual savings banks and mortgage bankers. This marks the first time that the private sector has aggressively entered the housing industry on a large scale by creating a secondary market for higher amount mortgage loans.

The program was designed to address the fundamental changes which are occurring in the methods of funding real estate mortgages. Due to high and volatile interest rates and deregulation, banks and savings and loans - the main providers of conventional mortgage loans - are less willing to hold fixed-rate long-term loans in their portfolios. Consequently, the secondary market has become an important source of financing for conventional home mortgages.

Prior to Residential Funding there was no major private investor who could provide large numbers of mortgage lenders with an ongoing access to this source of funds for residential mortgage credit. Basically, Residential Funding buys conventional (nongovernment-insured or guaranteed) mortgages from originating lenders and packages them into more marketable mortgage backed securities. These securities are then sold to investors such as pension funds, life insurance companies and savings and loan associations.

Public Sector Role

Prior to Residential Funding, the only other established way for lenders to access the secondary mortgage market was through two quasi-governmental agencies, FNMA and FHLMC. It is our understanding that these institutions were created by the Congress to provide a constant source of funds from the secondary market for mortgages of low and moderate amounts. This focus was insured by imposing a statutory ceiling on the mortgage loan size to be purchased by these agencies. From time to time the ceiling has been increased to allow for inflation and recently has been indexed in order to permit an increase in the ceiling as the index increases. Because of this statutory limitation these agencies can only package loans of $108,300 and under. It is important to note that approximately 88% of the total number of mortgages made to date are under $108,300. It is the other 12% of the residential mortgage market (comprised of loans over $108,300 which cannot be marketed through the agencies) that Residential Funding was designed to address.

Private Sector Role

As indicated, a void has existed in the secondary market for the higher amount mortgage loan. The private sector, recognizing this void, is seeking to fill it with programs such as Residential Funding. In just the first 4 months of operation, over 1,300 financial institutions nationwide have signed up to participate in the program representing a total of over $350 million in mortgage loan commitments made by Residential Funding.

To reach such a broad network of lenders, Residential Funding has coordinated with MGIC which has approximately 40 offices around the country. MGIC in turn uses their extensive sales force to introduce the program to commercial banks, savings and loans and mortgage bankers throughout the country. In addition, MGIC is instrumental in the underwriting of the loans and offers primary insurance for individual loans as well as the pool and special hazard insurance for the conventional mortgage backed securities (CMBS). Once Residential Funding purchases these loans, it packages them into CMBS which in turn are sold into the secondary market place. All our CMBS carry a "AA" rating from Standard and Poor, and have thus far found ready market acceptability among investors.

Residential Funding's conservative growth projections for the first year of operations indicate that it will purchase approximately $5 billion of residential mortgage loans. As the program expands, we expect additional private companies to begin entering this market as competition. Congress should recognize, however, that the amount of capital and human resources spent on research and development by private business to enter this market is substantial and will not be undertaken lightly.

We believe that to the extent Congress shrinks the available market, other private companies will decide not to enter the market. Indeed, Congress could, by unreasonably raising the mortgage loan ceiling thereby shrinking the higher amount mortgage loan secondary market, make it difficult if not impossible for our program and others like it to succeed.

Government Supported Mortgage Lending

As stated earlier, we believe that Congress intended FNMA and FHLMC, as quasi-governmental agencies, to focus on lower and moderate amount mortgage loans.

As a result of their agency status, FNMA and FHLMC are able to borrow their funds at below market rates. It is clear that the marketplace perceives FNMA and FHLMC to be quasi-government agencies. Thus, the marketplace accords these agencies a special borrowing status enabling them to offer a lender a mortgage rate that is below that which can be offered by a private company such as Residential Funding. Attachment A illustrates the effect of this rate advantage. As shown, Residential Funding's cost of going to the market to sell its securities reflects a range differential of 20 to 83 basis points over the cost for FNMA or FHLMC for the period shown. It is this rate advantage that has prevented the private sector from competing against these quasi-government agencies for mortgages under $108,300.

We have found through our own experience that we are just not able to compete successfully against FNMA and FHLMC for the lower and moderate mortgage loans. Less than 10% of the mortgage loan commitments made by Residential Funding are for loans under $108,300. Attachment B illustrates this point. The advantage of a below market rate is obviously judged by Congress to be another important way to ensure that the agencies are able to carry out their mission of providing mortgage money for the low to moderate income families who need a lower rate in order to qualify for a home loan.

Mortgage Ceiling Issue

As we have noted above, FNMA and FHLMC are now seeking legislation to have the ceiling raised above the

$108,300 level. Congress has very sound reasons for requiring FNMA and FHLMC to focus on the low and moderate amount mortgage loans. We believe that Congress recognizes that the total available resources are limited and that government-backed funds should only be used for those with the greatest need -- low and moderate income people. Higher loan amount home buyers should not be given such public support. It seems critical to us that FNMA and FHLMC remain focused on providing liquidity for that sector of the marketplace which they were designed to serve and leave the balance to the non-government entities.

Experience has shown that FNMA and FHLMC will end up controlling those sectors of the secondary mortgage market that they are allowed to enter to the exclusion of others. I firmly believe that if a private company such as ours is ever to have a meaningful role in this market, we must be given time to further develop our network of lenders and a broader acceptance for our securities.

In the long run, we believe that all competitors for higher amount mortgage loans should compete on equal terms, otherwise, this country will end up with the entire secondary mortgage market controlled by government sponsored agencies.

It is clear to all of us, I'm sure, that in the long run private capital will be needed to help fund the housing needs of this country. We believe that for this to happen FNMA and FHLMC should continue to use their government related advantages to target their resources to the low and moderate amount mortgage loan market and that private companies be allowed to compete for the higher amount mortgage loan market.

Conclusion

For these reasons, we strongly oppose an increase in the loan ceiling. Both FNMA and FHLMC have publicly stated that private sector entrance into the secondary marketplace should be encouraged. For this to become a reality, Residential Funding and all other private entities are looking to Congress for confirmation that their entrance in the secondary market is welcomed and encouraged and that the efforts and expense which they have undergone will not be undone by raising the mortgage loan limit ceiling for FNMA and FHLMC at this time.

"A"

Comparison of the Cost of Funds During 1983 for RFC and FNMA & FHLMC for 30-Year Fixed Rate Loan

1983	FNMA (Includes fees and 3/8 servicing)	FMLMC (Includes 3/8 servicing)	RFC (Includes servicing fee)
1/3	13.55% (.20)	13.20% (.55)	13.750%
1/14	12.92 (.58)	13.13 (.37)	13.500
1/19	12.92 (.83)	12.83 (.92)	13.750
1/24	13.17 (.71)	13.48 (.40)	13.875
2/22	13.42 (.33)	13.03 (.72)	13.750
3/24	13.22 (.53)	13.13 (.62)	13.750

Explanation:

This reflects the approximate 50 to 75 basis point advantage the two government backstopped lenders have over RFC in raising funds in the public markets.

"B"

Total Residential Funding Corporation
Loan Commitments as of February 28, 1983

Type Of Loan	% Under $108,000	% Over $108,000	Total $ Loaned
30 Year Fixed (Owner Occupied)	6%	94%	$ 89,242,785
30 Year Fixed (Non-Owner)	23	77	4,520,950
Early Ownership Mortgage	17	83	5,232,050
Step Early Ownership	16	84	39,229,084
15 Year Fixed	8	92	87,787,291
30 Year GPM	21	79	2,487,550
GRAND TOTAL	9%	91%	$228,499,710

Explanation: This chart demonstrates, by loan type, the percent of loan commitments made by Residential Funding under and over the FNMA and FHLMC loan limits.

General Electric Credit Corporation

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April 15, 1983

The Honorable John Tower
Subcommittee on Housing & Urban Affairs
United States Senate
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

During your March 10 hearings on authorizations for the Department of Housing and Urban Development, a distinguished panel of witnesses discussed the role of the secondary market in housing securities as a vital ingredient in satisfying the nation's future housing needs. Spokesmen for both the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) noted the absolute need for more private sector financial market participants to ensure the delivery of funding necessary for the purchase and sale of homes.

General Electric Credit Corporation concurs in the importance of developing a vigorous secondary mortgage securities market. Over the past two years GECC has positioned itself to take an active part in the development of that market through the organization of a private mortgage insurance company in 1980, the acquisition of a mortgage banking subsidiary in 1981, the filing of a $300 million S.E.C. shelf registration in 1982, and most recently the acquisition of a second and larger private mortgage insurance company in March of 1983.

During this same period of time Fannie Mae has begun to issue mortgage-backed securities of its own, $3.25 billion in 1981 and $14.0 billion in 1982. Fannie Mae has created these securities by packaging residential mortgage loans conforming with its statutory loan requirements, including the size limitation, which is indexed at $108,300, into pools and selling certificates evidencing an undivided fractional interest in the pooled loans.

Fannie Mae and Freddie Mac enjoy two commanding advantages over their private competitors in the packaging and sale of mortgage-backed securities that eliminate any possibility for meaningful competition in the secondary mortgage securities market with respect to loans conforming to National Housing Act requirements. The first of these advantages is Fannie Mae's and Freddie Mac's relationship with the United States Treasury, which enables them to sell their securities at a yield which, while slightly higher than that required by direct Treasury obligations, is significantly below that obtainable on the most highly rated private issues (e.g., Standard & Poors "AAA"). The second advantage is Fannie Mae's and Freddie Mac's exemption from S.E.C. securities registration requirements, which reduces their costs in packaging mortgage securities significantly below the levels achievable by private competitors.

In response to Fannie Mae's entry into the mortgage securities market and in light of Fannie Mae's and Freddie Mac's overwhelming governmentally-conferred competitive advantages, GECC has shifted its focus to packaging "jumbo" loans, those larger than the current federal limit of $108,300. These loans represent the remaining market open to the private sector, and, according to a Federal Home Loan Bank Board survey of 2000 mortgage originators conducted over the last six months of 1982, the dollar volume demand for residential mortgages in excess of $110,000 represents only between 6 and 8 percent of the total residential mortgage market.

It is GECC's understanding that Fannie Mae and Freddie Mac have now requested that the Subcommittee repeal all limitations on the size of the mortgages they may purchase and package into mortgage securities, and has also requested additional expansions of their powers and authorities. The elimination of lending limits for Fannie Mae and Freddie Mac will effectively foreclose private competitors from entering the mortgage securities packaging business and preclude private sector involvement in the development of the secondary mortgage securities market.

Accordingly, General Electric Credit Corporation respectfully urges that the proposed expansions of Fannie Mae's and Freddie Mac's lending limits and powers be rejected, at least until such time as these proposals can be considered on the basis of a full factual record of their potential ramifications and their effect upon the creation of vigorous secondary markets for mortgage finance in the private sector.

Very truly yours,

D. D. Dammerman
Vice President and General Manager
Real Estate Financial Services